Business Law Now!

Part I

Caterina Crucitti

bookboon
The eBook company

Caterina Crucitti

Business Law – Now!

Part I

Business Law Now! Part I
1st edition

ISBN 978-87-403-1107-5

Contents

Dedicated
With love and gratitude
To my wonderful parents
Maria Carmela Crucitti and Teodoro Crucitti (Dec.)

Preface

Business Law – Now! Is an online-textbook and is designed for the digital age business law students as part of a business or commerce degree and digital users of all ages, by providing instantaneous and flexible delivery of the business law information sought. Nowadays, many digital age business students are generally not interested in reading dense and often lengthy traditional style business law textbooks. This online-textbook therefore succinctly covers various Business Law topics such as the law of torts, especially negligence, contract law and vitiating factors such as misrepresentation, duress and undue influence, sales of goods, consumer protection legislation, agency and ethics. Instead of attempting to cover every aspect of these topics in great detail, the author has attempted to highlight the more important commercial and business applications of the relevant areas of business law.

Even though it deals with complex and often intricate legal issues arising in business and commerce, it is written in a simple and concise style. The law as contained and explained in this online-textbook is 'user friendly' as it is written in simple and plain English. There are precise definitions and explanations of key terms and legal issues within the modules for each area of the law. This textbook is structured in a way that supports the area of the law with illustrates case examples, diagrams and flowcharts and useful visual illustrations providing users with a clear sense of direction regarding the main issues being addressed in each of the module.

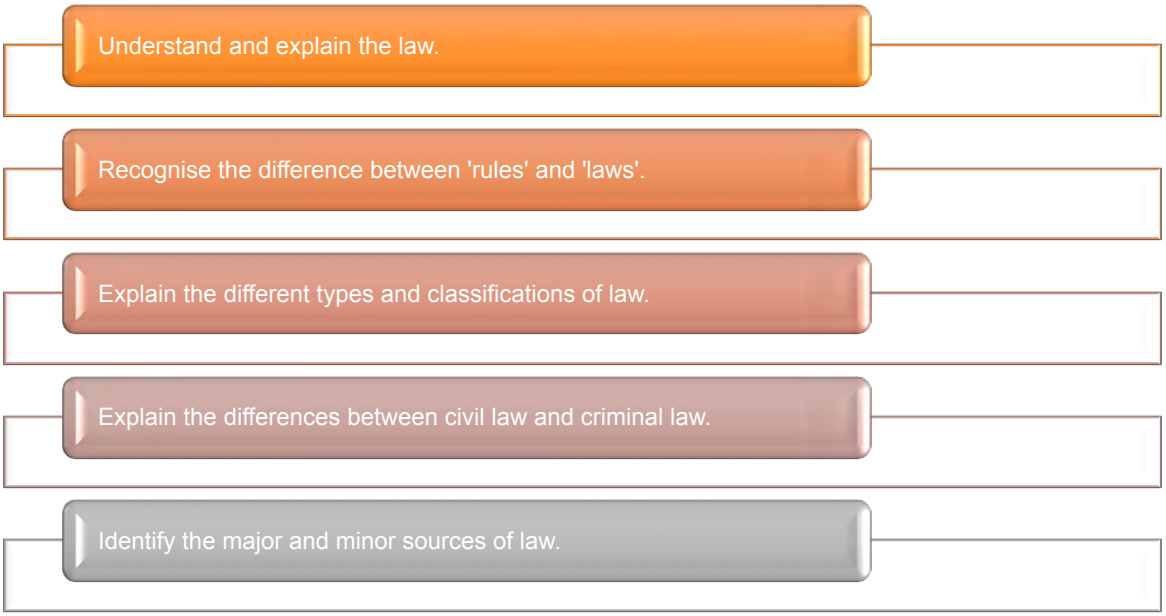
This book is dedicated with love and gratitude to my wonderful parents, Maria Carmela Crucitti and Teodoro Crucitti (Dec.), who gave me the gift of life, the foundations for learning and to always strive for excellence. My gratitude also to my husband and children for their patience and understanding for the time that I spent researching and writing this textbook and as well as to my siblings and immediate family for their love, encouragement and support and for everything they do to enrich my life.

Caterina Crucitti
Duncraig, Western Australia 2015

Module 1 Introduction to Law

Module Objectives

On the completion this this module, you should be able to:



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Civil (code) law: Is a complete legal system that has its origins in Roman law *(pax romana)* and the French Napoleonic Code.

Common law: Is the part of English (Westminster) law developed from the common custom of the as administered by the common law courts.

Defendant: Is the term referring to the party that is defending the civil action.

Equity: Arose as a result of the rigidity of the common law and refers to fairness or natural justice in respect to creation of laws (precedent).

International law: Is that body of law that is concerned with regulating conduct between different nation states outside national borders.

Law: is a device that is used to regulate people's interactions economically and socially within any given society.

Law merchant (*lex mercatoria*): Is that part of the common law that is concerned with commercial (mercantile) matters

Municipal (or domestic) law: Refers to the body of law that is concerned with regulating the relations or conduct between individuals and organisations within a nation's borders.

Plaintiff: Is the term used to refer to the party that commences a civil action

Procedural law: Consists of the rules of civil and criminal procedure and evidence.

Public law: Is that body of law that is concerned with the relationship between the state and individuals, such as for example, criminal law and constitutional law (state vs citizen).

Private law: Is that body of law that is concerned with regulating the relationships between individuals within the state, such as, for example, contract law and tort law (citizen vs citizen).

Roman law (*pax romana*): The civil codes that formed the basis of the civil (continental) law system.

Statute law: The laws that are passed (enacted) by the parliament.

Substantive law: Refers to the actual rights and duties of citizens under the law.

Writ: Refers to a document that is issued by a court directing that person to whom it is addressed to do, or to stop doing a particular act.

Introduction to Law

Law and the ideals that it stands for is difficult to define and over the millennia of time legal writers and philosophers, from Ancient Greece and Rome such as Socrates, Aristotle and Plato and to modern times, John Locke and Thomas Hobbes have tried to define law. Consequently, there are many varied definitions of the 'law' but the common theme with all of them is that, it is 'a set of rules that regulate the relationship of people in society to ensure legal, social and political order. The law, in the context of business law is also concerned with legal rules, principles and procedures to ensure that people who engage in business do so in a proper manner ensuring that transactions are entered into in a fair and just manner. Accordingly, the law maintains a 'balance' between the interests of all persons and business organisations and provides a mechanism for 'transparency' and 'checks and balances' to promote fairness, equity and consistency in the application of the law.

Therefore, business or commercial law is concerned with the rules, procedures and customs that are associated with various business activities, such as the sales of goods and services that are conducted on a regular daily basis such that impact on both contract law and tort law. Even though not everyone understand or even knows all of the law, it is presumed that everyone knows the existence of the body of law. This means that people cannot escape from legal responsibility by claiming that they did not know the law was being broken people are generally at a disadvantage if they do not have some idea of their legal position in society.

Law, therefore provides this knowledge, and it is a system of rules, imposed by the supreme authority in any politically organised society and recognised by its citizens as governing or regulating their conduct and interaction with one other. The nature of the law and in turn the 'rule of law' is such that is ensures social and legal order. In this context the word 'imposed' indicates that there is a 'command' by the law-making authority, an 'obligation' imposed on the citizens of society and a 'sanction' threatened in the event of disobedience. The fact that society recognises the power of the law, indicates not only that the citizens of the society may have the means of knowing, understanding and accepting what the legal rules are, being the 'requisites of the law, but also that a significant number of such citizens are ready to submit and be bound to those legal rules which are enforceable if they are broken in a court of law. Law is classified as common law and civil (code) law.

The 'common law' is the legal system of England and most of the English-speaking countries of the world. The 'civil law' is the legal system of most non-English speaking countries of the world and is based on Roman law as adapted and modernised in the Code Napoleon and its derivatives. It is not judge-made law but it's written or (codified) Law. Together, with this common classification of law, there are further classifications that can be made depending on whether the system is under civil law, common law or socialist Law. For example under the common law the law is further divided into the following subsets (or hybrids of law) and as illustrated by Figure 1.1 Types of Laws, namely public law; private law; administrative law; constitutional law; criminal law; international law; environmental law; commercial law and industrial law.

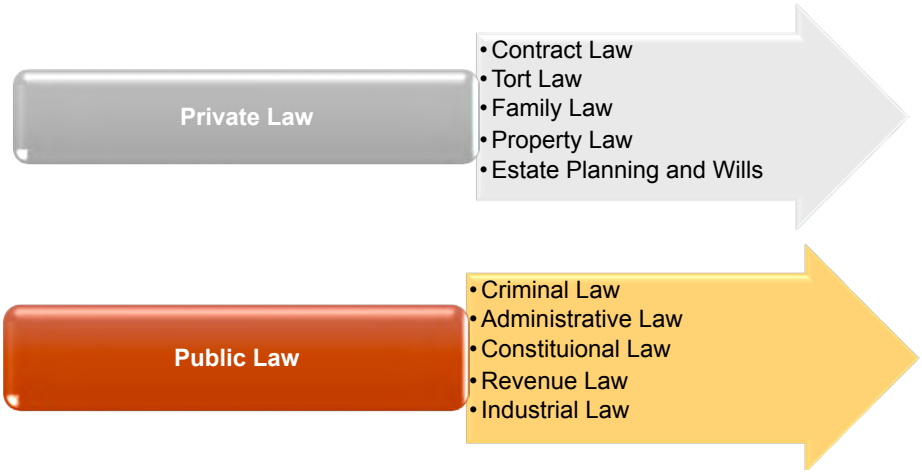


Figure 1.1 Types of Laws

1.1 Defining Law

There have been many definitions provided to explain the exact meaning of the term 'law'. In simple terms, 'law' is defined as the body of rules which regulate how people behave in certain circumstances. These rules have been designed by people in order to solve 'people' problems and they are intended to be obeyed by people in any given society. With the evolution of time of course, the idea or meaning of what constitutes Law changes with the needs and accepted norms of society. It should be made clear that not all rules become law. Many bodies, professional associations, schools and clubs in society lay down rules that must be obeyed and if they are broken then the person who broke the rule will be subject to punishment and even payment of a fine. But, these rules are not law as such, as they are made to regulate the activities of the individuals within those groups and they do not concern the general public as a whole.

Accordingly, law in our society consists of 'rules' which are recognised as actual 'law' by the public and which are enforced in public courts within the common or civil (code) law legal systems. The more we learn about how law has evolved and is made, a greater understanding of the 'nature of law' and the 'rule of law' can be ascertained. The law is a set of rules, developed over a very long period of time, which regulate people's interactions with one another. Law means different things to different people and it is the system of control through which society operates. Law declares how we must behave and consists of those rules which are enforced through the legal system (particularly the courts). Too many people within society whether in common law or civil code legal systems, the idea and phenomenon of law suggests rules and/or principles which have some binding force to them. They are laws having the weight of legal institutions of state behind them. Laws are either made by these public legal institutions or they are enforced by them.

1.2 Rule of Law

No person must suffer punishment or pay damages for any conduct not expressly forbidden by the law as determined through the courts. This concept that was formulated by Professor A B Dicey is the basis of any democratic society. Fundamentally the rule of law as advocated by Dicey and is still very relevant in today's globalised world which is far removed from the Industrial Revolution of the late 19th Century is based on the following three important ideals:

- That no person must be punished except for a breach of law and means that a person must be able to know the law and whether they are doing is lawful or unlawful;
- All persons are equal before the law irrespective of their status or position in society; and
- That the rights or freedoms of members of any society are enforceable in a court of law.

1.3 Requisites of the Law

There are a number of requirements that must be met by the law in order to citizens to be bound by them and they are as follows:

- ***Law must be certain:*** People in both their personal and business lives should be able to form relationships with others, enter into contracts, marry, and acquire and dispose of property, reasonably secure in their knowledge of what they are doing and their understanding of its effects.
- ***Law must be flexible:*** The law must be able to respond without undue delay to the challenges of change at all levels of society.
- ***Law must be fair:*** The effectiveness of law depends upon its acceptance by members of society. It will not be accepted where a law is inequitable, unfair or unreasonable.
- ***Law must be accessible:*** All citizens should have access to knowledge of the law, either directly or through intermediaries.

1.4 Types of Legal Systems

A legal system is the totality of laws that regulates a state, that is a legally organised community and there are a number of types of major legal systems, namely: common law legal systems, such as England; civil law legal systems such as the French Napoleonic civil code and *code civile* in Italy and other minor legal systems, such as Islamic and Hindu. However, law is generally classified into common law and civil (code) law.

1.4.1 Common Law

The 'common law' is the legal system of England and of most English speaking countries of the world. In the middle ages in England, each manor had its own court, dispensing justice according to the rule of the respective manor. Later, when a system of appeal courts was established with judges that went on circuit heard appeals from the manor court, the judges then looked for laws that were similar (common) amongst many of the manors and ignored detailed, minor and small differences. In this way the law evolved into the 'common law' of England and was pronounced as the law of the land by the presiding judges at that time.

The sources of law in the common law legal system as illustrated by Figure 1.1 Basic Sources of Common Law, are derived from the following major sources:

- ***Customary law*** – The law established by the habitual use of a group of people over a long period of time.
- ***Common law*** – The law developed by the courts.
- ***Legislation* (*statute law*)** – The laws made by the body recognised by the legal system as having the supreme power and authority to make laws (usually the parliament).

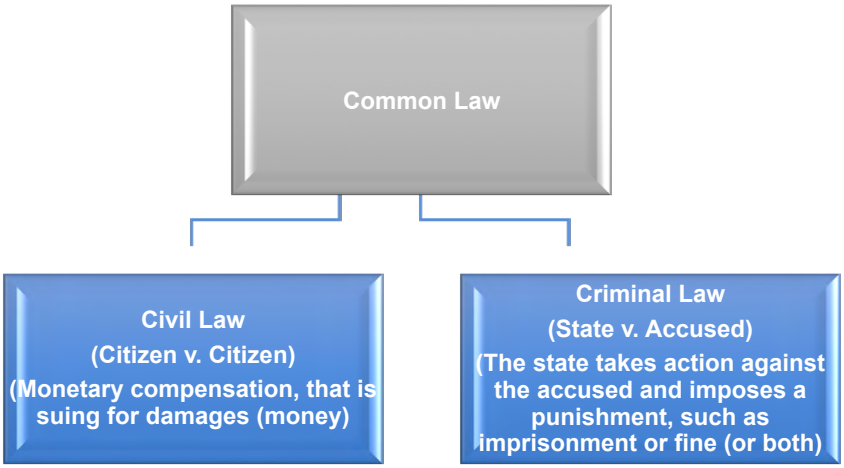


Figure 1.1 Basic Areas of Common Law

1.4.2 Civil (Code) Law

In contrast to the 'common law', the 'civil (code) law' is the legal system of most non-English speaking countries in the world and it is based on the Roman law. This 'civil (code) law' was later adapted and modernised in the code Napoléon and its many derivatives and forms arising from the Roman law. Essentially, 'civil (code) law', as a legal system in most continental European countries, is not the same as judge made law or the common law, but instead it is a 'written law' or 'code'.

1.5 Classifications of Law

Generally, it is possible to classify the legal systems of the world into three main families; civil law, common law and socialist law but this grouping is not exhaustive and there are a number of 'hybrids' within these major classifications. Most of these 'hybrids' or other legal systems that exist in the world possess characteristics which can be easily identified with one or more of these systems and therefore they provide a convenient starting point when considering a modern classification of legal systems in defining the Law.

In today's globalised world, that the civil (code) law system and the common law system are converging (blending) as a consequence of globalisation and the impact of technology such as the internet, necessitating for some consistency and respect between the different types of legal systems in respect to breaches of laws beyond geographical or legal boundaries. This convergence has arisen due to the fact that English style, common law legal systems are finding it difficult to rely on judge-made law and consequently, are also seeking or attempting to move to the codification of their laws, while the civil (code) law systems are beginning to acknowledge the existence and use of the doctrine of precedent, which is a unique aspect of the common law legal system.

There are further classifications within the 'common law' system and sometimes there is an overlap in the issues and circumstances of a case which frequently involves a number of legal areas within these general classifications. Current thinking is that, in the future the distinctions between the civil (code) law and the general common law systems may be 'blurred' which would effectively mean that they will be one and the same global legal system.

The English legal system is what is known as the common law system where legal principles are developed by judges through their determinations in cases and are therefore refer to established case or judge made law and giving rise to the doctrine of precedent. In England and other common law nations there are only two basic areas of law that can be identified and that is, as either civil law (citizen takes action against another citizen) or criminal law (state takes action against the accused) as illustrated by Figure 1.2 General Sources of Law.

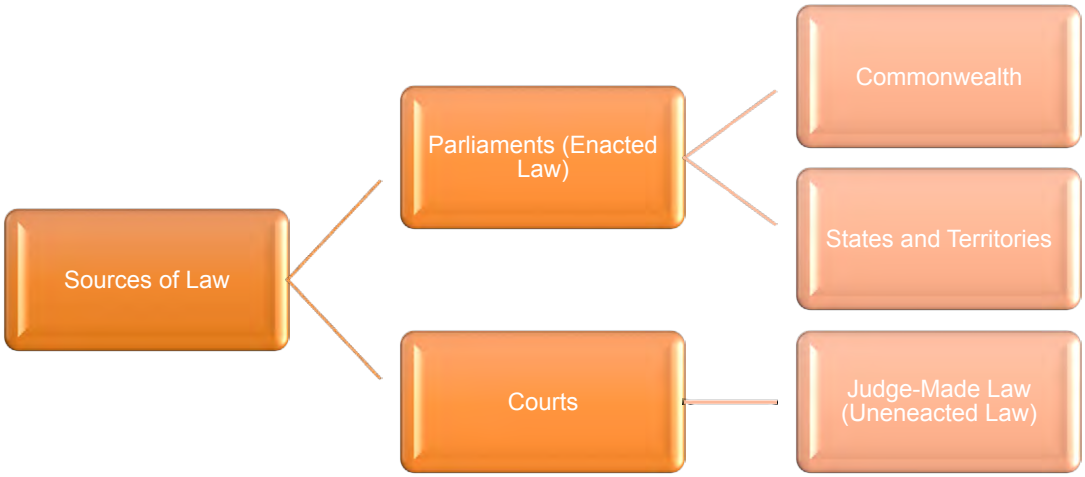


Figure 1.2 General Sources of Law

1.6 Statute Law and Common Law

There is a distinction between judge-made law that arises from the decisions of the judges from the cases that they hear and determine on the one hand and the law that is written in acts of parliament and delegated legislation commonly referred to as legislation, enacted law or statute law. The main difference between statue law and case law or judge made law is that, statute law is enacted law that is law made by parliament, while case or judge made law is made by judges and creates precedent within the common law legal system.

1.7 Criminal Law and Civil Law

This is the distinction between civil law and criminal law which generally involves serious breaches which are punished by the Crown and non-criminal law that is 'civil law' is where the Crown provides a court and judge to enable citizens to settle their disputes in a peaceful manner within the rules of natural justice, equity, due process and the rule of law. The main difference between criminal law and civil law is that, under the criminal law (public law action taken by the state) it is assumed that there is generally an intention (*mens rea* or "guilty mind") to do the wrongful act (*actus reas* that is the physical element or real act). In contrast in a civil law (private citizen) an action may arise out of negligence and contract law and intention need not always be present in order for the plaintiff to be able to take action for any wrong doing or damage suffered as a direct result of the actions or conduct of the defendant.

1.8 Classification of Civil Law (Common Law)

In respect to the civil law under which a citizen is able to take action against another citizen for any wrong or damage they sustained from the negligence or breach of contract by the other party, the civil law is further classified into subgroups of the law. Thus, the civil law (common law) legal system is broken down into the following three major classifications as illustrated by Figure 1.3 Classification of the Civil Law.

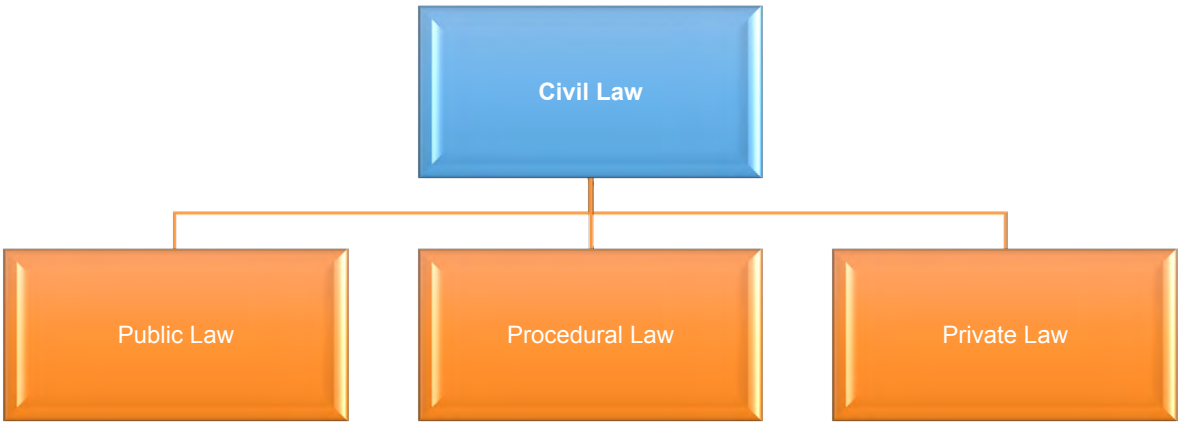


Figure 1.3 Classification of Civil Law

1.9 Criminal Law

Criminal law is an action that is brought by the Crown on behalf of the state against an individual for doing an act which the state considers to be a crime and which is generally punishable by a penalty such as a fine, imprisonment or both. This term also refers to the rules of statute or enacted law as well as common law rules which dictate that certain actions are punishable by the state. The main element in an action under the criminal code is that the accused actually 'intended' to do the act. The Crown in such an action must prove its case against the accused 'beyond reasonable doubt'. The main features of a crime include the following:

- ***It is public***: The criminal conduct is more than offence against an individual as it is also an offence against the community and the general public and is normally a moral and ethical wrong.
- ***It is immoral or not immoral***: Not all immoral conduct such as cheating or unethical conduct is of a criminal nature and not all criminal conduct is immoral or unethical such as disobeying some rules of the road.
- ***It is punishable under the law***: This involves penalties for the crime such as imprisonment, a fine or loss of rights and does not generally involve any form of compensation for the injured person.

1.10 Civil Law (Common Law)

Civil law refers to the law, generally the law of tort that enables any member of society to take an action against another person for harm or injury as a result of that person's negligent act or failing to do something. A person taking such action must prove their case on 'balance of probabilities' and often the victim is seeking compensation for the loss suffered. A tort is a civil wrong other than a claim for breach of contract and for which a right of civil action for damages may arise. For the injured party, the plaintiff to establish on the 'balance of probabilities' (as it is a civil wrong and action – tort) the plaintiff must prove that the defendant owed a duty of care, that the duty of care owed was breached and that as a result of such breach the plaintiff suffered actual loss or damage that is recognised by law such as negligence.

Key Points

Key points in this module are:

MO1: **Understand and explain what Law is:** There is no universally accepted agreement on 'what is law'. However, a starting point would be that the law is a set of rules and regulations that have developed over very long periods of time that regulate peoples interactions economically and socially with one another in society.

MO2: **Recognise the difference between rules and actual laws:** It should be noted that rules do not automatically become law. To determine whether a rule is law, it must first be established where the rule came from, how it deals with an offender who has broken that particular rule, the type of punishment and whom will hand out the appropriate punishment.

MO3: **Explain the different types and classifications of laws:** Laws may be classified in a number of ways and include the following:

- **Common law legal system** which is based on precedent (judge made (un-enacted) law) and statute (enacted) law as is found in most commonwealth nations while **civil law system** that is based on a code based legal system of continental European nations.
- **International law** that regulates the conduct between states outside their borders.
- **Municipal or domestic law** that refers to a state's internal laws inside its borders.
- **Public law** is concerned with the organisation of government and with the relationship that that subsists between the people and the government, such as for example constitutional law, taxation law and industrial law.
- **Private law** is concerned with the relations that subsists between natural and legal persons, such as for instance contract law, torts law, property law and company law.
- **Substantive Law** which refers to the actual rights and duties of citizens under the law.
- **Procedural Law** which consists of the rules of civil and criminal procedure and evidence.

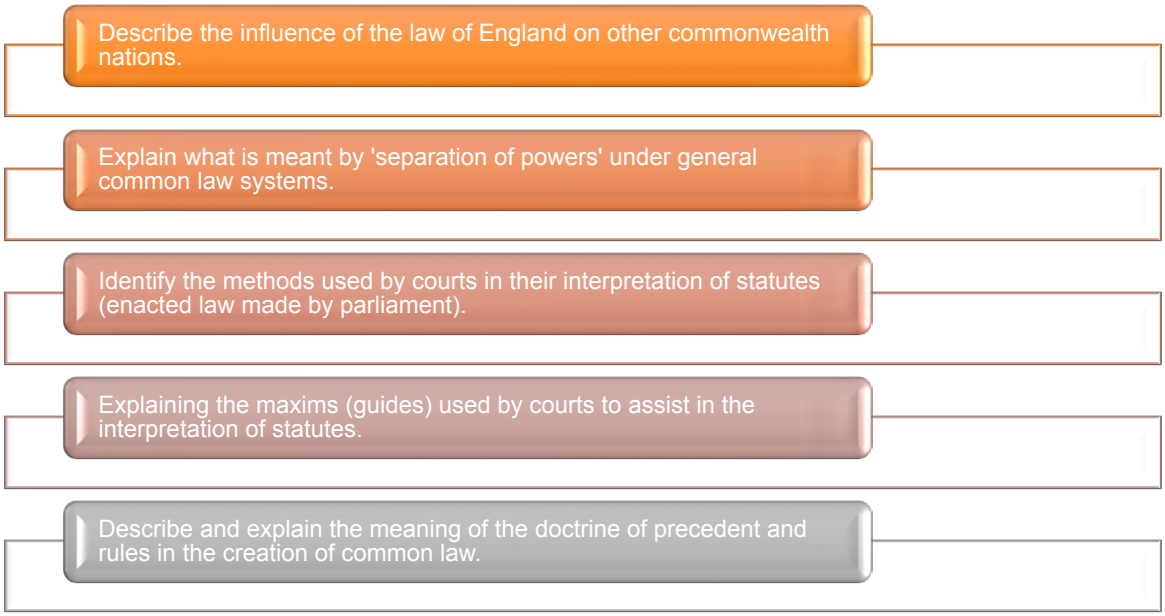
MO4: **Explain the differences between civil law and criminal law:** The main distinction between civil law and criminal law is that civil law involves an action between individuals (citizen vs citizen) where the plaintiff has to prove on the balance of probabilities that their case is more believable. Criminal law (State vs Accused Citizen) arises when an action is brought by the state against the accused has committed a wrong for which they ought to be punished under the law.

MO5: **Identify the major and minor sources of law that comprise the English Legal system:** There are three major types of laws within the English legal system and they are common law (precedent/ un-enacted) law, equity (fairness and justice) and statute (enacted) law, and the minor types of laws includes the law merchant (*lex mercatoria*) and Roman law (*pax romana*).

Module 2 Legislation and Constitutional Law

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Act (also known as a 'statute, legislation or enacted law): Is a Bill that has been passed by the Houses of Parliament and received Royal Assent or Approval in any given nation.

Bill: Is a proposed legislation or a proposed law which at this stage is not law as it has not been assented to or approved by a majority vote.

Constitution: Refers to the form of the supreme government in any state and refers to the fundamental sets of rules governing that sate.

Extrinsic material: Is external material apart from the section that is under consideration, including such things as headings, subheadings, marginal notes, end notes, reports of Royal Commissions, Law Reform Commissions, committees of inquiry, explanatory memorandum and parliamentary reports.

Key Cases

Amalgamated Society of Engineers V Adelaide Steamship Co (1920) 28 CLR 129
Brownsea Haven Properties Ltd v Poole Cooperation [1958] CH 574
Gray v Pearson (1857) 6HLC61; 10 ER 1216
Heydon's Case (1584) 3 CO Rep 7a; 76 ER 637
Mills v Mee King (1990) 169 CLR 214
Powell v Kempton Park Racecourse Co Ltd [1899] AC 143
Re Bolton; Ex parte Beane (1987) 162 CLR 514
Smith v Hughes [1960] 1 WLR 830

Legislation and Constitutional Law

Today's modern society has seen an increased role in judicial interpretation of legislation (enacted law) in order to ascertain their exact meaning and purpose in order for legislation to be administered and enforced in a consistent manner and fairly. The complexity of modern society and its rapid changes due to globalisation and other factors, such as political, cultural and legal influences has meant that the general common law of nation's whether based on the English common law system or civil (code) based legal systems have to be supplemented by the enactment of legislation, codes, Act or statute for efficiently regulating society. Accordingly, due to the increased complexity of domestic legislation and ratified international legislation it is often difficult to ascertain exactly what is meant by a particular word or phrase because the actual scope and extent of the words expressed in the legislation that apply to any given set of facts or circumstances are often vague, ambiguous and unclear.

Thus, the occurrence of these inherent problems in analysing and interpreting the exact provision, word or phrase in any legislation can lead to significant problems in the application of laws to the given facts or circumstances. Therefore, it is important that apart from actually determining the facts of any particular case it is necessary that the Courts interpret Statues to enable them to arrive at a suitable decision and determination in the particular case. In this regard the Courts rely on other sources to assist them in interpreting the provision or provisions of a statute or enacted law by an Act of parliament.

2.1 Legislation and Statutory Interpretation – Level 1

Legislative or statutory interpretation has been described by Professor Sir Rupert Cross as a 'process by which the courts determine the meaning of a statutory provision for the purpose of applying it to the situation before them' (John Bell and George Engle, *Cross: Statutory Interpretation* 3rd ed, 1995 34). In common law nations, courts are required by legislation, Act or statute in each of their jurisdictions to adopt a "purposive approach" in statutory (legislative) interpretation as opposed to applying the historical approaches that were developed at common law and often referred to as general common law rules of statutory interpretation.

Statute law has now become such an important part of the general common law legal system in many common law countries. Generally a law that is, the form or structure of the legislation, Act or statute is very difficult to draft concisely, because it expressly states a Law or proposition that can sometimes cover countless situations, and will cast confusion and doubt as to the exact meaning of the legislation (statute). As a result of this 'conflict', 'confusion', 'absurdity' or 'confusion' the judges often find that they have two competing roles and according the court has to interpret legislation.

The first is that the judge in a court of law has to determine the actual meaning of the words that are used in the provision of the legislation in respect to the current situation and secondly the judge has to consider the meaning of the particular statute in the context of the existing body of law which includes both the general common law as well as legislation or statutory law, and in most cases also includes the nation's *Constitution.* This is often difficult to attain a precise meaning of enacted law because the English language that was historically used is not always precise or clear and the meaning of the actual words, clauses or phrases of the provision may have changed with the passage of time.

Also, parliamentary drafters who actually wrote the words, phrases and clauses of statutes do not always express or construct the phrase in an ideal or perfect manner that clearly conveys the wishes or actual intention of the parliament. Even though within common law nations, each jurisdiction drafts legislation that avoids complex legal jargon and in a manner that attempts to assist with interpretation of the legislation, Act or statute through clarity of its form and structure, the complexity of legislation often results in ambiguities and unintended consequences that were unforeseen at the time of drafting the legislation, Act or statute. Apart from the enactment of general laws by parliament, there are also other types of statutes (Acts or legislation) that are formed or constructed for specific and defined purposes.

These types of Acts include the following: amending the Acts that enables approved changes to be made to existing law; repealing the Acts which are no longer good law and prevent them from existing any further or from having any future legal effect; explanatory Acts that describe the actual meaning of the Act; declaratory Acts that declares, clarifies and identifies actual law; consolidating Acts that combine for consistency specific Acts that address similar legal issues and laws and enabling Acts that operate to effect and passes law granting powers to subordinate authorities possessing delegated legislation such as city councils, schools, universities and hospitals.

2.2 Changing the Constitution – Level 1

In respect to changing a nation's Constitution or laws the process to initiate such changes is very complex and is not embarked on by either common law or civil law (code) nations for trivial or minor changes. In respect to changing the *Constitutions* most of the constitutions of nations' would provide that the *Constitution* can only be amended or changed if a number of specific and at times complex requirements are fully satisfied and complied with. Also the proposed changes generally have to go to a referendum and must be passed by a majority of voters.

2.3 Statutory Interpretation and Guides (*Maxims*) – Level 1

Statutory Interpretation refers to the process undertaken by courts to interpret Acts before determining their proper application. There are a number of important and fundamental reasons for interpreting Acts and they include the fact that, particular words of Acts may be vague or unclear; Acts may not clarify all future applications; and Acts may not clarify the intention of parliament

Therefore, with the fact that legislation is very complex and subject to different 'interpretations', very often doubts arise as to the exact meaning of a particular word, clause or phrase because of the actual extent to which the words in fact would apply to any given situation or facts is often uncertain and not very precise or clear. These doubts in turn create major problems and difficulties in applying any given set of written rules or principles which often necessitates the courts have to apply the various methods for interpreting any given statute (Act or legislation).

As a result of this increased complexity of legislation, the courts are concerned not just with determining exactly what happened in any situation being a 'question of fact' but are also concerned with the actual interpretation of statutes which is a 'legal question'. Therefore to assist in the courts interpretation of statues, the courts rely on a number of sources and guidance which includes the following: other Acts of interpretation; extrinsic materials; common law rules of statutory interpretation; maxims (or aids and guides to construction); and the doctrine of precedent.

2.4 Common Law Rules of Statutory Interpretation – Level 1

The common law rules of statutory interpretation are very useful and benefice to the interpretation of the Acts and in ascertaining what the 'actual purpose' was at enactment by the parliament. These common law rules of statutory interpretation (guides or maxims to construction) include the literal rule, the golden rule, the mischief rule and the class rule *(ejusden generis)*. The use of judicial interpretation to determine the exact meaning of statutes or phrases in states is illustrated by a number of court decisions including *Powell v Kempton Park Racecourse Co Ltd* [1899] AC 143 and *Brownsea Haven Properties Ltd v Poole Cooperation* [1958] CH 574.

2.4.1 Literal (Plain Meaning) Rule – Level 2

The literal rule is used to interpret words of an Act as it was written thus applying the literal meaning of the words and in this case judges can use dictionaries to identify the meanings of particular words. In respect to the judicial interpretation of statutes by the application of the literal or plain meaning rule the case of *Amalgamated Society of Engineers V Adelaide Steamship Co* (1920) 28 CLR 129 illustrates this application in relation to statutory interpretation.

2.4.2 The Golden Rule – Level 2

The golden rule is used when the literal rule would result in an inconsistent or illogical outcome, or when the literal rule is inconsistent with the purpose of the Act and is used to apply a more lenient definition by taking into consideration the circumstances and the purpose of the Act. The judicial interpretation of statutes by applying the gold rule is illustrated by the case of *Gray v Pearson* (1857) 6HLC61; 10 ER 1216.

2.4.3 The Mischief Rule – Level 2

The mischief rule is applied when the literal rule has been applied but the outcome is still ambiguous. It is also aapplied to determine the real purpose behind the Act that is the purposive approach and it is used to identify the mischief or misdemeanour that the law is trying to prevent. The application of the mischief rule in respect to judicial interpretation of statutes has been illustrated by the cases of *Heydon's Case* (1584) 3 CO Rep 7a; 76 ER 637 and *Smith v Hughes* [1960] 1 WLR 830.

2.4.4 The Class Rule (*ejusdem generis*) – Level 2

***The class rule* (*ejusdem generis*)** refers to words that can be grouped together and labelled under a general term.

2.5 Purposive Approach and Extrinsic Materials – Level 1

The *Acts Interpretation Acts* are traditionally used to assist the courts with the interpretation of Acts (statutes or legislation) but this often also led to ambiguities and inconsistencies in their interpretation and application. As a result parliaments often introduce amendments directing the courts to interpret legislation in such a manner that it truly reflects the actual or apparent purposive or intention of the legislators that is commonly referred to as a 'purposive approach or construction'. This purposive approach of statutory interpretation is in fact an extension of the 'mischief approach' which a one of the common law rules that is often applied by the courts to assist with interpreting Acts. The purposive approach is an improvement in the interpretation of an Act because instead of just focusing on the actual problem, the courts now are compelled to look at the main or actual purpose of the Act. The application of the purposive approach to statutory interpretation by the courts is illustrated by *Mills v Mee King* (1990) 169 CLR 214 and *Re Bolton; Ex parte Beane* (1987) 162 CLR 514.

Accordingly, to utilise this approach under the general common law the courts have to now interpret the words of the legislation in a manner that will allow the particular legislation to achieve its main objective or purpose, instead of just relying on the literal approach which may be deficient in achieving the main purpose or objective of the Act upon its enactment.

One of the significant outcomes of the purpose approach is that the legislation now allows the Courts to use extrinsic (external) materials to assist in the interpretation of provisions or sections of Acts. As a result of this shift from the traditional approach of statutory interpretation the common law courts, can now use the following extrinsic or external materials in order to assist with such interpretation, namely, reports of any Royal Commission, Law Reform Commission and committees of inquiry; explanatory note or memorandum that is attached to the Bill; any document that is declared by the Act to be relevant; Parliamentary debates; headings, margin notes and end notes of the Legislation being reviewed; anything else that was recorded in the official reports of Parliamentary proceedings; and international treaties or agreements that are referred to in the Act.

2.6 Maxims (Aids) to Construction – Level 1

Maxims are not rules of law but instead are aids or guides to the actual construction of an Act. Even though the legislative drafters to their very best to define words in a way that all possible interpretation is covered, unfortunately there can be no single definition that can cover all situations or perfectly describe a class of people, things or acts. Accordingly, there are a number of maxims or aids to construction that the courts can use to assist in determining the actual meaning of a word or phrase and the two most important ones are: *noscitur a sociis* – 'it is known from its associates' or the context rule and is used where a word is ambiguous or unclear in a group of specific words; and *ejusdem generis* – 'of the same kind, class or nature' and is known as the class rule and it is used to find a viable meaning for a broad general word.

2.7 Problems with Statutory Interpretation – Level 1

There are a number of problems with statutory or legislation interpretation due to the fact in the manner in which they are constructed. The courts over have adopted a number of methods, approaches and interpretive strategies to assist courts of law to interpret the actual 'construction' and 'meaning' of particular Act (statute or legislation), but nevertheless problems continue to persist. These problems in respect to the interpretation of Acts often arise as a result of certain inherent difficulties with the doctrine of precedent and associated rules and principles, such as difficulties in actually identifying the *ratio decidendi* (reason for the decision that creates the binding precedent); difficulties differentiating between the *ratio decidendi* and *obiter dictum* (persuasive or influential only); the precedent may have more than one *ratio decidendi* even though the cases be determined may be similar, it is unlikely that they are identical and jjudge's may be bound to follow prior similar decisions although they may lead to unjust outcomes which is not an accepted or desires outcome.

2.8 Basis of Precedent – Level 1

To encourage certainty, consistency, and fairness in the English style of adversarial system of laws, the evolution and application of the doctrine of precedent is fundamental to the common law. The origins of the English method and system of precedent is illustrated by Figure 2.1 Origins of Precedent. The main basis of the system known as 'precedent' (doctrine of precedent) is simply that where a court has decided a case in a similar manner, then in subsequent cases involving similar facts should be decided in the same way. The legal principles that apply to any given facts should apply to all similar facts in similar case in the future. The most significant thing about precedent is that it develops and creates the common law and that it gives rise to two types of precedent, namely:

- A binding precedent (arising from the *ratio decidendi* – 'reason for the decision' – of a case) – which is binding and must be followed and applied in all cases; and
- A persuasive or influential precedent (arising from the *obiter dicta* – 'sayings by the way' – of a case) – which are not binding on other courts, but are considered by the courts in making its decision and may be followed in some cases if appropriate.

Accordingly, a binding precedent only gives rise to the *ratio decidendi* of the case while a persuasive precedent which is not binding is referred to as the *obiter dicta* of the case.

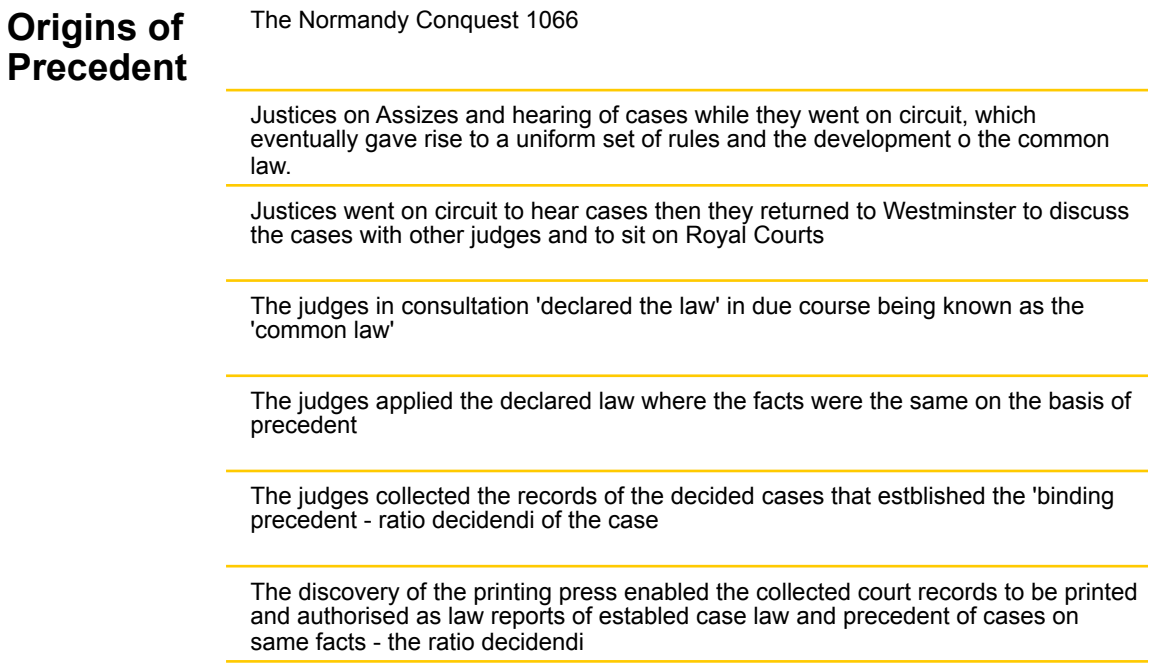


Figure 2.1 Origins of Precedent

2.9 Construction of Legislation – Level 1

In order to assist with interpreting and or determining the '*construction*' that is interpret or '*construe*' an Act, statute or legislation, the courts have applied several approaches and strategies to assist them with the interpretation of a particular Act or Acts. In order to understand such approaches or strategies it is essential to look at the '*structure or form – construction*' of an Act. Any Act contains a number of special 'characteristics' and headings to assist with reading, interpreting and understanding the particular act or statute and includes such things as:

- The number of the Act (if relevant) and is important as it informs of the actual date in which the Act was passed by Parliament.
- The table of provisions, known as the index or table of contents for the purpose of enabling specific sections of the Act to be found easily.
- The title of the Act which states the specific purpose of the Act or statute.
- The date of assent (enactment) which is important as it identifies the starting date of the new law.
- Internal division of the Act allowing for easy reference and consists of several specific Parts and categories.
- The purpose of objects clause clearly setting out the objectives of the Act as it was intended by Parliament upon enactment and is beneficial in the process of interpretation.
- Headings which are beneficial in assisting with easy reference and research into the Act.

2.10 Judge Made (Case) Law – Level 1

The primary feature in the case or judge made law in both common law and equity (fairness) is the doctrine of precedent. A precedent is defined as a 'judgment or decision of a court of laws that is cited as an authority for the legal principle or decision. Basically, following a precedent means that a legal issue should be resolved in a similar manner as a previous decision, and this process of following an established and consistent procedure is commonly known as *stare decisis* and underpins the doctrine of precedent which is illustrated by Figure 2.2 Doctrine of Precedent.

2.10.1 *Ratio Decidendi* (Reason for Deciding) – Level 2

In a decided case it is only the *ratio decidendi* which means the reasons for the decision of the case that is binding. This means that only specific parts of the decided case, that is, legal principles on which the particular case was decided are binding and any other legal statements made by the Judges are not binding. In their concluding judgments in a case, Judges will make statements based on 'principles of law' which generally give rise to the *ratio decidendi* of that case and is generally binding on all lower courts in the same hierarchy. All the other legal statements that are made by the Judge in the case that were not necessary to decide or determine the case are not binding and are called *obiter dicta.*

2.10.2 *Obiter Dicta* (Sayings by the way) – Level 2

Legal statements or remarks that are not binding in a case are called obiter dicta. They are remarks in passing by the judge that is, 'sayings by the way', and to not form part of the actual binding precedent. In some instances *the obiter dicta* of the Higher Courts or eminent Judges may in fact, form the basis for a future biding precedent (the *ratio decidendi* of the case).

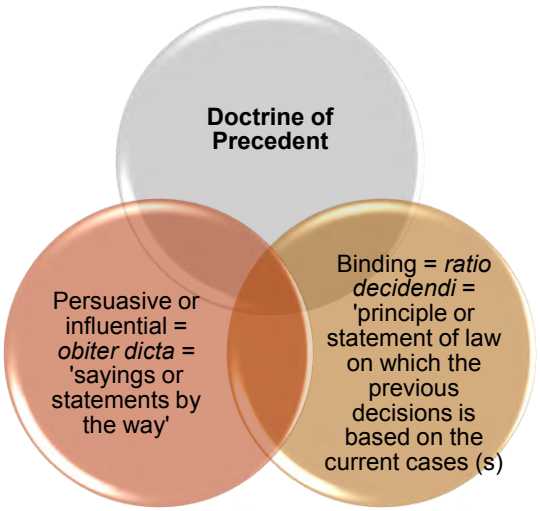


Figure 2.2 Doctrine of Precedent.

Key Points

Key points in this module are:

MO1: Describe the influence of the common law of England on other commonwealth nations: The English common law is the system of law developed by the English courts through the principles of precedent and adopted in Commonwealth countries with a British heritage.

MO2: Explain what is meant by 'separation of powers' under general common law systems: Refers to the division of government powers between the legislature(parliament), which makes the law, the Executive which administers and enforces the law and the Judiciary which applies the law and is similar to the distribution of power. The main principle is that power should not be concentrated in the hands of any one individual or institution, but balanced across the branches of government and that those who hold and exercise power should be subject to external check and has given rise to the expression "checks and balance".

MO3: Identify the methods used by courts for their interpretation of statutes (enacted law): To assist in interpreting statutes, the courts apply one or more of the following approaches to the interpretation of statutes, such as *Acts Interpretation Acts* and purposive approach; extrinsic materials; common law rules of statutory interpretation such as the literal rule, golden rule, mischief rule and maxims and doctrine of precedent.

MO4: Explaining the maxims used by the courts to assist in the interpretation of statutes: The maxim *noscitur a sociis* ('it is known for its associates') or the context rule refers to general words of a statute that are construed in the light of their context and is interpreted by looking at specific words associated with it. On the other hand, the *ejusdem generis* (class rule) is used when general matters are referred to in conjunction with a number of specific matters of a certain type and operates to limit the general word to the same class as the more specific words preceding it.

MO5: Describe and explain the meaning precedent, *ratio decidendi* and *obiter dictum*: The doctrine of precedent is very important in the creation of consist and fair laws within the general common law. Precedent operates in three ways: Firstly, in relation to courts in the same hierarchy, a court lower in the hierarchy must follow the decision of a higher court. The decision of the higher court creates a binding precedent. Secondly, Courts generally follow their own prior decisions and thirdly in general, courts are not bound by courts outside their hierarchy, although they recognise the value of judgements from courts in other states and common law countries. The idea of 'binding' includes not only the strictly binding nature of a specific answer to a specific question, but extends further to include the authority of a general proposition from a high court used to determine the issues in that higher court.

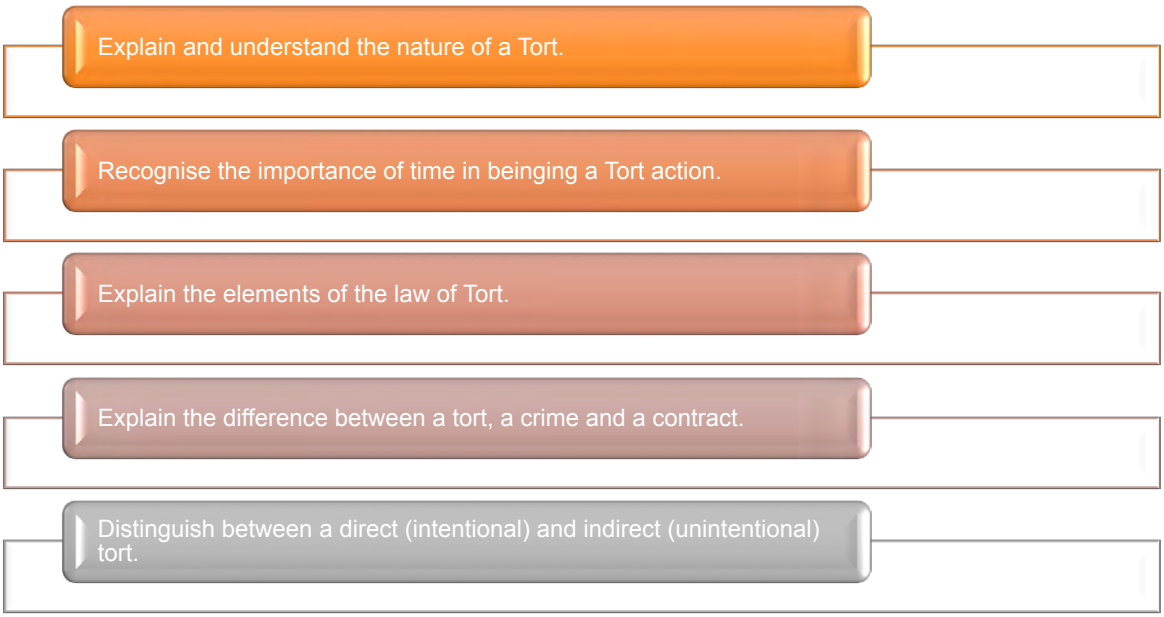
MO5 (a) ***Ratio decidendi*** – The *ratio decidendi* ("reason for deciding") is the basis for the doctrine of precedent and it is the legal reasoning upon which the decision in that case was based and may be used by judges in future cases when confronted with similar facts.

MO5 (b) ***Obiter dictum*** – Anything said about the law in the course of a judgement that does not form part of the matters at issue is not binding, however persuasive it may be. Such comments are called *obiter dicta*, "sayings along the way". However they can exercise an extremely strong influence in a lower court and even in a court of equivalent standing.

Module 3 Law of Tort

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Actionable per se: Means that an action can commence without the need for the plaintiff to establish proof of damage, and the mere fact that the tort such as Trespass has occurred enables the Plaintiff to take action against the Defendant.

Negligence: Is an indirect (unintentional act/conduct) interference with the person or property of the plaintiff.

Tort: Is a civil wrong other than a claim for a breach of contract.

Trespass: Is a direct interference (intentional act/conduct) with the person or property of the plaintiff and is actionable without proof of damage that is, actionable per se.

Key Cases

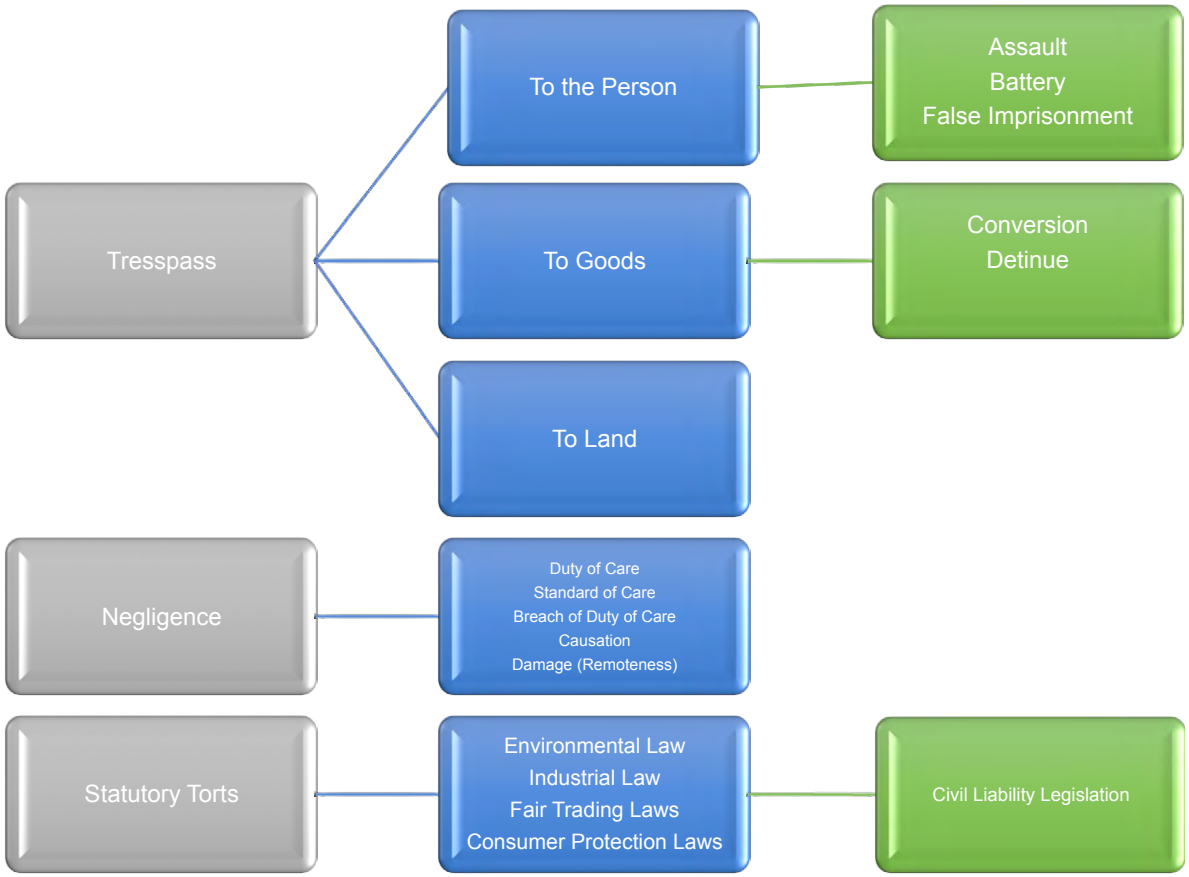
Blyth v Birmingham Waterworks Co (1856) 11 Exch 781
Lochgelly Iron & Coal v M'Mullan [1934] AC 1
Price v Easton (1833) 4 B & Ad 433
Beswick v Beswick [1968] AC 58

Law of Tort

The word *Tort*, is a French word which means a *"wrong"* and in turn a "*civil wrong*", it arises when someone deliberately and intentionally does an act or conduct that harms or injures another person or their property, such as Trespass (direct tort) or unintentional (indirect) through carelessness or accidental conduct causing harm or loss to another person or their property, such as negligence (indirect tort). Thus, a tort is, a civil wrong that allows remedies, usually in the form of monetary compensation, referred to as 'damages' for harmed caused, whether intentionally or unintentionally in the particular circumstances. In support of the definition of a tort see the Figure below on the classification of Civil Wrongs (Torts).

The law of tort is a classification of law that involves wrongs, referred to as civil wrongs. It involves one person taking action against another person for causing that wrong and infringing that person's private right or interests as a result of the breach of the duty of care that was owed in the given circumstances. The action is a private (civil law: citizen vs citizen) cause of action where the plaintiff has to prove their case on the *balance of probabilities* that their version of events are more believable based on admissible evidence, witness statements (if any) and their statement.

Even though a tort can also be a crime they give rise to different causes of action and outcomes and are distinct from one another. The law of torts sets the limits of private rights and the types of behaviour which gives rise to an actual interference with an individual's right. Essentially the role or function of the law of torts is that it determines within certain legal and financial constraints when a person suffering any loss or injury is able to claim compensation for that loss or injury against another person for the tort within specified time limits as laid down by the relevant *Limitations Acts*.



3.1 Tort of Negligence

In most legal systems there are two main sources of torts Law generally under the common law and statute or code Law and in the event of a clash between the two, generally statute law will prevail as the current law. There are a number of functions and roles of the law of torts but its primary focus is on protecting rights and providing remedies, such as awarding monetary compensation (damages) for the harm or damage done as a direct result of the tort (civil wrong) such as negligence. One of the main functions of the law of tort is to determine Liability and to provide a remedy only when all of the elements of the law of tort have been satisfied by the plaintiff. A Tort is a civil law matter which means that only the interests of the particular individuals are involved. Generally negligence is described as doing what an 'ordinary and prudent person would not do, or *failing to do* (constituting the actual breach of the duty of care) what an ordinary and prudent person (that is a person with normal intelligence) would do, as is illustrated by the English cases of *Blyth v Birmingham Waterworks Co* (1856) 11 Exch 781 and *Lochgelly Iron & Coal v M'Mullan* [1934] AC 1. In accordance with the established view and precedent in respect to the evolving tort of negligence Lord Wright in *Lochgelly Iron & Coal v M'Mullan* [1934] AC 1 at 25 stated as follows: 'In strict legal analysis, negligence means more than heedless or careless conduct, whether in omission or commission: it properly connotes the complex concept of duty, breach, and damage thereby suffered by the person to whom the duty was owing.' Since then however, with the passage of time and changes in the legal environment in relation to duty of care and analysis of actual harm and risks (especially in respect to obvious risks and dangerous recreational activities among others), that there have been significant and much needed statutory reforms in the area of the tort of negligence by why of various *Civil Liability Acts* of jurisdictions.

The main purpose of the law of tort is for the wrongdoer to compensate, that is pay back, the person who suffered a loss or injury and not to punish the person who is responsible. The legal process of the law of tort actually involves determining who is at fault and the extent of the damage. Under the law of tort the wrongdoer or tortfeasor (the defendant) if liable must repay the injured person, the plaintiff for the loss or injury in the form of damages. This monetary compensation in the form of payment (damages) could also include out-of-pocket expenses such as medical expenses, lost wages or loss of earnings. There are also other types of damages for which a dollar value is difficult to attach and for any plaintiff who suffered pain may also be awarded an amount of money for pain and suffering.

3.2 Sources of Tort Law

The two main sources of torts law are:

- Common law which is historically the most substantial and important source. The common law as inherited from England and provides a system of 'derived similar cases when the justices went around on circuit to hear cases and eventually, became known as the common law'. Thus, the 'common law' is based on following previous decisions (precedent) of judges in similar situations but over time have been significantly altered in by enacted laws made in parliament; and
- Relevant Acts (statutes or legislation) within the particular legal system.

3.3 Function of Tort Law

The main function or purpose of the law of torts is to award damages for the wrong or harm arising from an unlawful or illegal purpose. The aims of an action for damages in tort have been identified as consisting of the following possible outcomes, depending on the circumstances and nature of the damage, harm or injury:

- Appeasement (that is, to make amends/restore);
- Justice (based on the principles of equity, fairness, due process, natural justice and rule of law);
- Deterrence (that is preventing loss or wrong /criminal conduct giving rise to the loss or injury);
- Compensation (that is, awarding monetary compensation for the loss);
- Loss spreading and prevention (that is, minimising loss, damage or injury).

A tort (civil wrong that has arisen from an unintentional harm) can be distinguished from crimes (criminal wrongs that arise from intentional harm) in a number of ways especially in respect to the remedies sought and outcomes of the action. The law of torts operates independently as well as being related to a number of other areas of the law such as criminal law, contract law, restitution and intellectual property law.

3.4 Elements of Tort Law

The law of tort is concerned with accidental injury to a person and can be either physical or mental or to the property of a person. The law of tort is based on two fundamental principles or elements, namely:

- An act or omission by the defendant interfering with a right or interest of the plaintiff that causes the plaintiff damage, loss, injury or harm; and
- The interference must give rise to an actual cause of action for damages awarded to compensate the plaintiff for the loss.

3.5 Private Rights and Interests

The law fundamentally is concerned with the safety and wellbeing of an individual in society as well as the protection of his or her property and rights. This function or role of the law has been handed down through the ages from the old version of the law of tort to the modern version which now incorporates negligence includes negligent misrepresentations and product (manufacturers) liability. However, there are some circumstances where the law does not actually protect some interests as it may be too vague, difficult, and complex, lacks jurisdiction or simply through tradition has not involved itself with that cause or action or wrong. For example the law does not always provide remedies for losses that are financial and not directly associated with personal injury or damage to or loss of property either real or personal. In respect to the law of tort an aggrieved or injured person whose right has been breached by the acts or omissions of another, especially if that person owes them a duty of care will have a cause of action against that plaintiff for the harm and injury caused.

3.6 Classification of Torts (Civil Wrongs)

There is no universally accepted classification of torts (civil wrongs). However, to enable the plaintiff to commence a proper action under this area of the law, torts (civil wrongs) are classified in the following two main ways, according:

- to the *actual nature* of the wrong that has occurred; or
- to the *type of damage* that is done and/or directly flows from the wrong.

Some of these civil wrongs may be classified in the following manner as illustrated in Figure 3.1 and Figure 3.2.

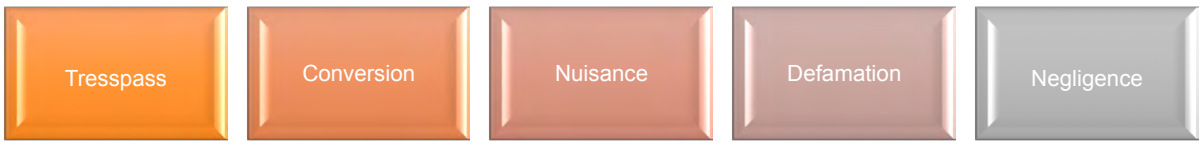


Figure 3.1 Torts (Kind of Civil Wrong)

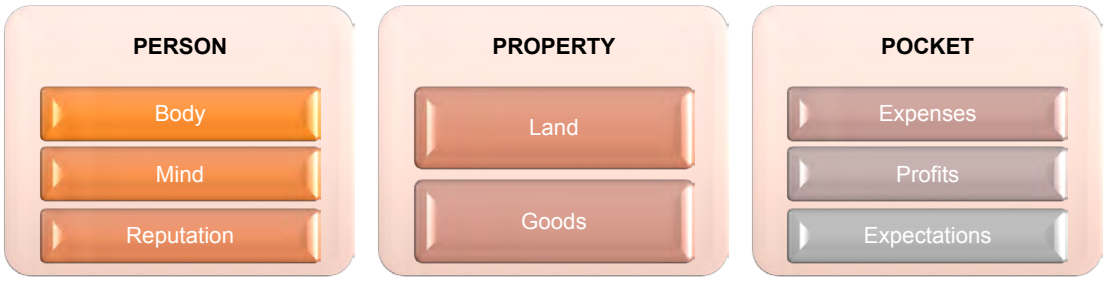


Figure 3.2 Torts (Kind of Damage)

3.6.1 Trespass to Person or Property

Trespass is a *direct interference* with the person or property and it is the oldest form of torts. There are a number of protected interests under this classification of torts and includes personal safety and freedom, tangible personal property (chattels) and intangible property (land or real property).

3.6.2 Personal Safety and Freedom

- ***Assault*** – a form of the tort of trespass that consists of an intentional act or threat that directly places the plaintiff in a reasonable belief that there will be physical interference with his or her person.
- ***Battery*** – the reckless or intentional application of force to another person without consent, lawful excuse or justification.
- ***False imprisonment, detention or wrongful imprisonment*** – unlawfully totally restraining the liberty of another person.

3.6.3 Tangible Personal Property (Chattels)

- ***Trespass to goods*** – a direct, forcible and wrongful interference with chattels or goods of another.
- ***Conversion*** – an intentional dealing with chattels, without lawful justification and in a manner that is inconsistent with someone else's actual or constructive possession or immediate right to possession of those chattels (goods).
- ***Detinue*** – the wrongful detention of goods (chattels) after the plaintiff lawful request to have them returned.

3.6.4 Intangible Property (Land or Real Property)

- ***Trespass to land*** – the intentional or negligent act of a person that directly interferes with another person's exclusive possession of land without any legal ground.

3.7 Private Nuisance

Private nuisance (is in the nature of a miscellaneous tort) is an *indirect interference* with the use and enjoyment of land. Private nuisance unlike public nuisance, which protects people against direct physical intrusions onto their land protects against annoying, inconvenient or harmful activities outside the land which indirectly interferes with their use and enjoyment of it. Examples of private nuisance include: noise, loud music, strong lights, smell, vibration, noisy pool filters, dogs barking, overhanging branches and signs, large and obtrusive satellite dishes, smoke or vapours. In such case of private nuisance a remedy is available to the person who is in actual occupation of the land and can personal action such as reasonable force and abatement or seeking court orders for damages and or an injunction.

3.8 Remedies for Torts

In respect to an action in tort the following remedies are available:

- ***Damages* (*Common Law Remedy*)** – monetary compensation for the loss, harm or injury.
- ***Injunction* (*Equitable Remedy*)** – court order preventing or stopping the loss, harm or injury to continue such as in trespass, nuisance or defamation.
- ***Declaration* (*statement of claim*)** – A statement by the court that is made for purpose of resolving a legal dispute or issue which is not coercive or enforceable unlike a court order which is coercive and enforceable.

REMEDIES UNDER TORT LAW

The Law of Tort provides compensation to the injured party, the Plaintiff by providing compensation for the following damages:

- Personal physical and emotional injuries
- Damage to property, including public and private nuisance
- Intentional attacks on reputation, Defamation
- Interference with family relations
- Interference with certain contractual relationships by third parties
- Personal use and enjoyment of property, namely trespass and private nuisance
- Economic and financial loss as a direct result of fraud or negligence, such as negligent misrepresentation or misstatement.

3.9 Statute of Limitations

There are time limits in respect to when a plaintiff can commence legal action against a defendant under the law of tort. For instance within England (common law legal systems) there is generally some uniformity in respect to limitation periods on actions in tort, such as defamation which must be commenced within one year. The date on which the time commences to run, that is the date that the injured party must commence the action, depends on whether the tort is *actionable per se* (without proof of damage) or not which means that damage must be proved.

This distinction in respect to time limits for torts action is important because it dictates when the action for the specific Tort should commence after it is committed. For example, in torts that are *actionable per se,* time commences to run from the date of the act committing the actual tort; while in other torts such as negligence, where it is necessary to prove damage as part of the cause of action, time will generally commence to run from the date when the actual damage, injury or harm actually occurs. An injured party should take action within a certain time after the tort otherwise the action may become '*statute barred*' because of the operation of the *Limitations Acts.*

3.10 Liability for Breach of Duty

There are a number of breaches of public and statutory duty that gives rise to an action by plaintiff in given circumstances and includes:

- ***Public nuisance*** – an unlawful act or a failure to discharge a legal duty that is related to land which interferes with the enjoyment of a right available to the public and may result in the offender being prosecuted.
- ***Breach of statutory (torts) duties*** – arises where there is a breach of industrial safety provisions and the requirements and elements for a successful action by the plaintiff are similar to the tort of negligence.

- ***Interference with judicial process*** – arises where there is contempt of court, bribery and corruption, negligence and trying to interfere unlawfully with judicial process.
- ***Invasion of privacy*** – This new tort of invasion of privacy allows a plaintiff to sue if it can be established that the behaviour was offensive and cause the plaintiff to suffer stress, anxiety and trauma as a result of the invasion of privacy.

3.11 Liability for Misrepresentation

In respect for misrepresentation causing harm, injury or loss, a plaintiff can sue for damages in respect of the following conduct that may arise during contractual negotiations and will cause the injured party to seek compensation for damages as a result of such conduct or behaviour that has caused economic, financial or personal loss or damage, and include deceit (fraudulent misrepresentation); innocent misrepresentation, defamation, injurious falsehood or passing-off.

3.11.1 Deceit (Fraudulent Misrepresentation)

These are representations that are fraudulently made during contractual negotiations that have the tendency to induce the other party into a contractual agreement where there is no genuine consent.

3.11.2 Innocent Misrepresentation

This is a type of misrepresentation that lacks any element of fraud or coercion but was made innocently without intention to deceive. The misrepresentation was made negligently and arises were a person gave information in the honest and reasonable belief that it was correct and in stations which there is no special relationship, in such cases there is no remedy in tort.

3.12 Defamation

The tort of defamation refers to communications made orally or written that has the tendency of lowering and/or damaging the reputation of the plaintiff in the community causing other people to avoid, exclude, ridicule or despise the plaintiff. This may lead to personal, economic or financial harm or damage for which the injured party may seek redress and monetary compensation, for the harm if in fact the defamatory statement was false.

3.13 Injurious Falsehood

This is an economic tort that nay be used by a business to sue other businesses or individuals who make false, misleading or fraudulent statements about the plaintiff's goods or services which causes financial and economic loss as was highlighted by the case of *Perre v Apand Pty Ltd* (1999) 164 ALR.

3.14 Tort of Passing Off

This is an economic tort that involves a misrepresentation by the Defendant that their goods or services are connected with those of the Plaintiff, which is an intellectual property right, such as for example, using someone's trademark and name to induce people to believe that the two businesses are connected.

3.15 Liability for Intentional Damage

A plaintiff can seek compensation for any intentional damage or loss in respect to the following:

- Interference with contractual relations – a defendant who knowingly induces a contracting party to break a valid existing contract is liable to the other party to the contract in tort.
- Conspiracy – is a tort, but may also be a crime and arises when it is established that there has been an agreement between two or more persons to do an unlawful act with the intention to injure the plaintiff's business or other economic interests and the act must be carried out and actual damage suffered by the plaintiff.
- Intimidation – is part of the tort of intentional interference with trade or business by the use of threats, force and other unlawful means that induce or coerce the plaintiff into entering into the contract or agreement without genuine consent and for which damages may be awarded.

3.16 Torts and Crimes Distinguished

There are many situations where people are harmed by someone else's action, but no crime has actually taken place. Imagine that Sophia slipped on a wet floor in a shopping centre and sprained her ankle. Sophia may have suffered a wrong, but the shopping centre owner (the occupier) is not a criminal. The shopping centre owner however, has a duty of care that is owed to all persons entering the premises occupied or controlled by the shopping centre owner, and may have to compensate Sophia for a civil wrong, that is under the tort of negligence, but specifically for occupier's liability. Even though a tort and a crime are two different things, sometimes one action can in fact be both. If someone has deliberately injures another person, as in assault (trespass to the person), the person committing the assault may be charged with the crime of 'assault, in a criminal Court. Thus, in this instance, the accused person may also be responsible for compensating the injured person for things such as medical expenses as well as pain and suffering.

The law treats crimes and torts as two separate issues and generally, criminal courts are not concerned with determining compensation for victims and nor are civil courts set up to punish wrongdoers but to seek monetary compensation in the form of damages for the injured person. Tort law comes mainly from the common law (case law or judge-made law). While this law has developed over time to protect citizens from loss or injury, they are not paid back any money for the harm or injury sustained automatically. The injured person, the plaintiff, must first show that another person's action caused their loss. As with other areas of civil law, such as contracts, divorce, rental disputes, nuisance, defamation and paying debts, the courts should be used only after other attempts to settle the matter out of court have failed. These differences between a crime and a civil wrong (tort) and the processes or actions involved in each action is illustrated by Figure 3.3 Differences between a Crime and a Civil Wrong.

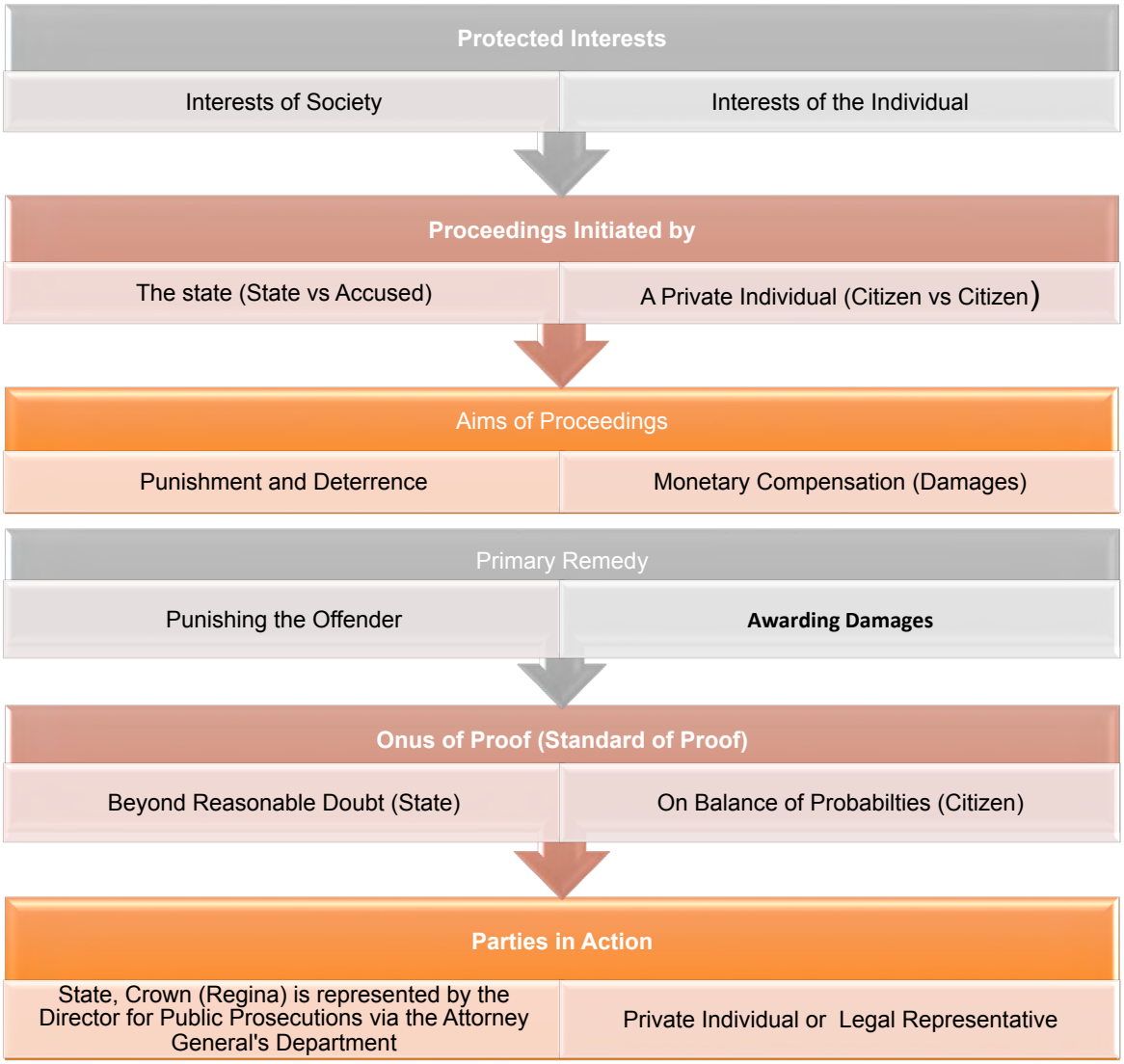


Figure 3.3 Differences between a Crime and a Civil Wrong

3.18 Rights Protected by Torts

Under the law of tort there are two main types of rights that are protected and these rights are known as *absolute rights* and *qualified rights* as is illustrated in Figure 3.4 Rights Protected by the Law of Tort.

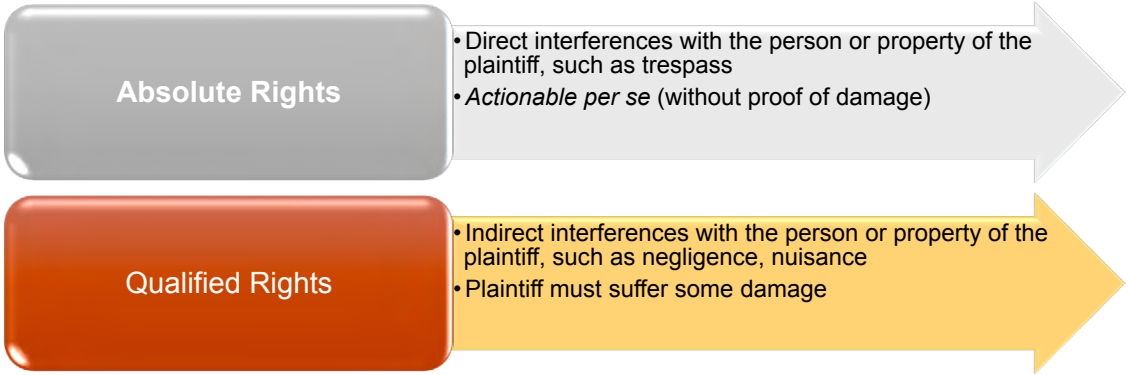


Figure 3.4 Rights Protected by the Law of Tort

3.19 Tort Law and Other Law

Tort law does not operate in a vacuum despite it being a distinct area of private law. Thus, there is a tort has a relationship and is interlinked with other areas of the law such as criminal law, contract, law, he law of restitution and intellectual property law as it outlined below.

3.19.1 Tort Law and Criminal Law

Even though some torts are also crimes, the actual functions, processes and outcomes of criminal law (public law) and civil law (private law) are very different. In the past, actions that commenced in tort as a result of a crime were not permitted to proceed until the criminal prosecution was completed. However, this requirement is not strictly followed in courts of law and today, this decision on whether to hear criminal and civil cases concurrently relating to the same breach, crime or facts is at the discretion of the court.

3.19.2 Tort Law and Contract Law

Under the law of tort, duties based on the '*standard of a reasonable person*' are owed to the whole world, while contractual duties are owed only to the other contracting party (privity of contract) as is illustrated by the case of *Price v Easton* (1833) 4 B & Ad 433 and *Beswick v Beswick* [1968] AC 58. As a result of the duty of care and neighbour principle in tort law, duties in tort are imposed by the law, whereas contractual duties are actually agreed upon by the parties who intend to be bound by the terms and conditions of the contract. It should be noted that there can be concurrent liability, which means that liability can arise both in contract law and tort law out of the same facts. In these instances, the actual content and scope of the duty in tort may be affected by the contractual agreement between the plaintiff and the defendant.

3.19.3 Tort Law and Restitution

Tort law and unjust enrichment are different legal events triggering different causes of legal actions and outcomes for the plaintiff and there is some overlap. The law of torts is concerned with compensation for losses arising out of a wrong to the plaintiff who sues for damages, while on the other hand, unjust enrichment requires *'restitution*' that is restoring, of the benefits obtained or received by the defendant that were unjustly and at the expense of the plaintiff.

3.19.4 Tort Law and Intellectual Property

The law of torts, together with contract law and restitution, are based on moral not to infringe another person's rights of ownership, such as for example, in intellectual property and the law of torts in this situation provides protects proprietary interests.

3.20 Compensation outside Tort Law

Other forms of compensation instead of an action in tort for injury which do not depend upon proving that a Tort has been committed, is found in statutory schemes such as that may be applicable in the particular circumstances, such as workers compensation schemes; criminal injuries compensation schemes; motor accident compensation schemes and insurance.

In the past as now, many people protect themselves against having to bear the cost and misfortune of accidents on their own by taking out insurance. People can insure against their own accidents or accidents that have been caused by other and for which they are found legally responsible for breaching their duty of care that was owed to the injured person. Even though a person may be insured for a number of situations and occurrences, insurance will not be able to cover any situation.

3.21 Fault Based Compensation

The shifting of loss for some types of loss through the law of torts depends on the aspect (element) of fault. If there is the intention to do the wrong, such as trespass, there is fault (actual intention, that is, *mens rea,* the guilty mind) to cause harm, injury or loss (*actus reas,* that is, the real act). If there was no intention, such as in an action in negligence, then there was no intention to the wrong which was caused indirectly, unintentionally or accidentally. In some cases liability is imposed regardless of actual fault (without proving any damage or injury) is known as *'strict liability'* such as in relation to corporate crimes by company directors and other company officer as well as other legislative breaches.

There are a number of criticisms with 'fault-based system' of compensation for injuries because of the fact that:

- The element of 'fault' is not always sufficient or necessary to allow for the shifting of loss;
- The legal responsibility owed does not always coincide with moral blame;
- The actual degree of fault can be out of proportion to loss;
- The ability to pay is not taken into account;
- The victim may be in need of compensation also when no one was at fault;
- Proof of actual fault can be difficult to obtain and lack of proof prevents recovery; and
- Insurance would bear the loss.

Key Points

Key points in this module are:

MO1: **Explain and understand the nature of a Tort**: A tort is a civil wrong other than a claim for a breach of contract and for which a right of civil action for damages (monetary compensation) may arise.

MO2: **Recognise the importance of time in bringing a Tort action**: An injured party under tort law has a limited to set by statute within which to commence an action or the action may become statute barred.

MO3: **Explain the elements of the law of Tort:** The main approach to the law of tort is based on there being an act or omission by the defendant that interferes with some right or interest of the plaintiff which causes the plaintiff damage, and the interference gives rise to a cause of action for damages which should as nearly as possible be equal to the plaintiff's loss.

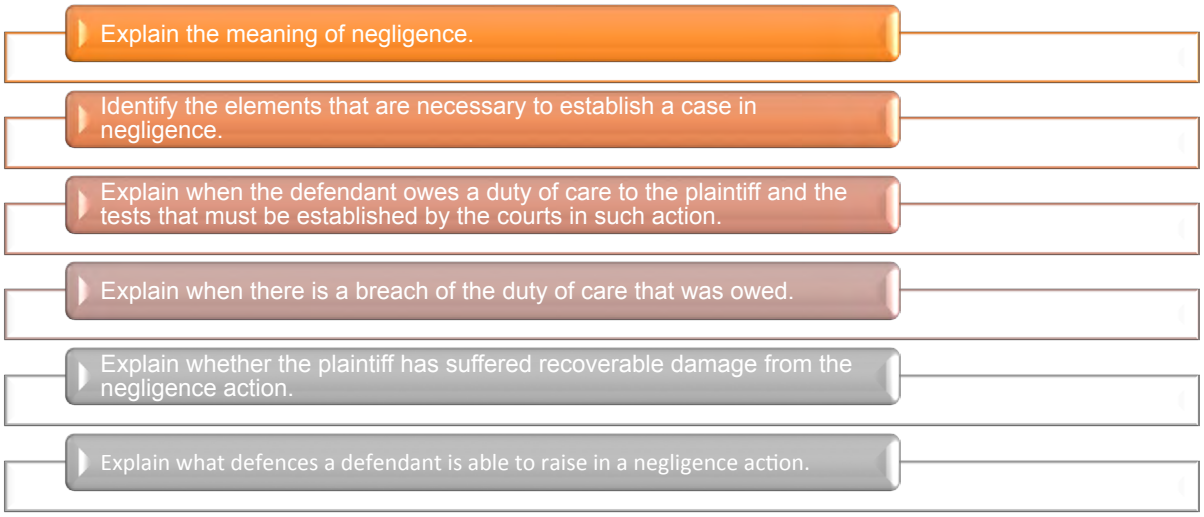
MO4: **Explain the difference between a Tort, a Crime and a Contract**: The main difference between a tortious action and a criminal prosecution is generally one of purpose. In tort for instance the parties are concerned with the resolution of a private dispute that may result in the awarding of some appropriate remedy, whereas on the other hand, in criminal proceedings the prosecutor is a representative of the public and is concerned with the punishment of the accused offender and the deterrence of crime. Contract law however is concerned with the enforcement of contractual promises and compensation if there is a breach of a valid contract while Tort is mainly concerned with the protection of civil rights.

MO5: **Distinguish between a direct (intentional) and indirect (unintentional) tort:** Intentional (direct) torts are based on actions on the action of trespass and can arise where the defendant intentionally carries out a wrongful or wilful act that directly causes harm to the plaintiff.. For example, trespass to the person which includes assault, battery, false imprisonment, and trespass to land and to goods. In contrast, unintentional (indirect) torts are based on action on the case and involves an omission or a consequential injury, such as for example negligence.

Module 4 The Tort of Negligence

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this Module.

Foreseeability: In civil law it refers to anticipation or awareness, knowing in advance the likelihood of some future event or circumstance occurring that led to damage. Foreseeability is a prerequisite for establishing negligence and also to determine whether the resulting damage is too remote. To be successful in an action in negligence the plaintiff must be able to prove on the balance of probabilities that the kind of injury caused by the defendant was reasonably foreseeable based on the standard of the reasonable person.

Negligence: Is a Tort that is actionable by a person who has suffered damage as a result of the defendants breach of duty to take care to refrain from conduct or other acts that a reasonable person could reasonably foresee as being likely to insure a plaintiff. The tort of negligence is premised on three elements that need to be satisfied for an action in negligence: a duty of care was owed, a breach of that duty of care and resulting damage that is not too remote and foreseeable.

Reasonable Person: In tort law the reasonable person 'embodies a standard to which real people are to be held'. Thus, in tort law the reasonable person is deemed to be someone of normal intelligence, credited with such perception and awareness of the surrounding circumstances and such knowledge of other pertinent matters as a reasonable would possess. If a person holds a particular skill then the law requires that the person shows such (reasonable) skill as any ordinary member of the profession to which they belong would normally show.

Res Ipsa loquitur: Is a legal maxim that means 'the facts speak for themselves'. This maxim describes the legal position where the circumstances of an accident are such that there is little doubt the that the accident would have happened only because of the defendant's negligence, and that in the absence of further evidence the defendant would be held liable for the harm or injury.

Key Cases

Blythe v Birmingham Waterworks Co (1895) 11 Exch 781 at 784
Bolton v Stone [1951] AC 850
Cork v Kirby Maclean Ltd [1952] 2 All ER 402
Donoghue v Stevenson [1932] AC 562 at 580
Grant v Australian Knitting Mills (1935) 54 CLR 49
Hay (or Bourhill) v Young [1943] AC 92
Jaensch v Coffey (1984) 155 CLR 549
Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound No 1) [1961] AC 388
Paris v Stepney Borough Council [1951] AC 367
Perre v Apand Pty Ltd (1999) ALJR 1190

Tort of Negligence

The modern tort of negligence, which is one of the best known torts was developed from the decision of the House of Lords in *Donoghue v Stevenson* [1932] AC 562, which is reported at <http://www.bailii.org/cgi-bin/markup.cgi?doc=uk/cases/UKHL/1931/3.html&query=Donoghue%20v%20Stevenson>.

Case Summary: The Snail in the Ginger Beer Bottle

A young couple went to a cafe for a drink and the boyfriend bought his girlfriend a bottle of ginger beer. The girl drank some of the ginger-beer (which was in an opaque bottle), and the remainder was poured into her glass, which to her disgust contained the decomposed remains of a snail. After seeing this together with the fact that she had already drunk some of the ginger beer, the girl suffered severe shock and gastro-enteritis. When she recovered she wanted to claim compensation for the damage/injury suffered by her as a result of drinking the ginger beer that contained the decomposed snail. As she did not buy the drink herself and there was no contract between her and the Cafe owner, she knew that she could not obtain any compensation from the seller of the drink, the Cafe owner as he did not manufacture the drink. Instead she brought action against the manufacturer, who had bottled the drink, for lack of care. This case is very important as it involved a very important point of law that the case eventually went on appeal to the House of Lords who decided the case in favour of the girl (Plaintiff) as they found that the manufacturer has been negligent, thus giving rise to the modern version of Negligence, The House of Lords found that the manufacturer owed a duty of care, towards anyone who would eventually drink the ginger beer, to exercise reasonable care in the manufacture of the drink. The House of Lords stated that if a manufacturer failed in this duty, the manufacturer would be liable to compensate anyone who drank the contaminated drink and suffered harm or injury.

In general terms, negligence refers to conduct or behaviour that is careless and that causes foreseeable harm to another person if they fail to take reasonable care and is illustrated by Figure 4.1: Summary of Elements of Negligence. However, being careless or reckless is not in itself a *civil wrong*, and consequently anyone who is injured as a result of the carelessness or recklessness cannot just for that reason, sue and claim compensation from the careless person for any damages. Negligence however, in a legal sense, is much more complex because it involves deliberate (intentional) acts, unintentional acts and omissions that actually caused the damage, harm or injury to the Plaintiff. In special situations as imposed by law, the tort of negligence imposes a *duty* on a person to act with *'reasonable'* care towards others. If a person breaches this duty of care that is owed, and that other person suffers damage, loss or injury that was reasonably foreseeable the tort of negligence has been committed. In ascertaining whether there has been a breach of the duty of care in any given situation, the courts apply the objective test of a reasonable person, and the expected standard that was required in the particular circumstances, profession or trade by the person doing the careless act or conduct.

4.1 Elements of Negligence

To prove that's there was an act of negligence by a plaintiff, then in order to succeed in such negligence action the plaintiff (injured party) must establish on the *balance of probabilities* (*civil action*) that a defendant (the tortfeasor) has in fact been negligent, was at *fault* and *actually caused the harm*. Thus in this legal sense and meaning of 'negligence' the plaintiff must prove the following three elements, (as is illustrated in Figure 4.1 Summary of Elements of Negligence) and as developed from the case of *Donoghue v Stevenson* [1932] AC 562, that the:

- Defendant (tortfeasor and the wrongdoer) owes the plaintiff a *duty of care*.
- Defendant breached that *duty of care*.
- Plaintiff *suffered loss*, damage, injury or harm that was caused by the breach.

It is necessary for a successful action in negligence by the plaintiff, that all of these three elements are established. If any one of these elements is not satisfied and answered in the affirmative with a *'Yes'*, then the plaintiff may not succeed in the negligence action and any damages awarded may be reduced if the defendant (the tortfeasor) can raise the defence of voluntary assumption of risk (*volenti non fit injuria*) or contributory Negligence. In the tort of negligence, actual liability is dependent upon what a reasonable person would have foreseen or anticipated or how a reasonable person would have acted in the given circumstances.

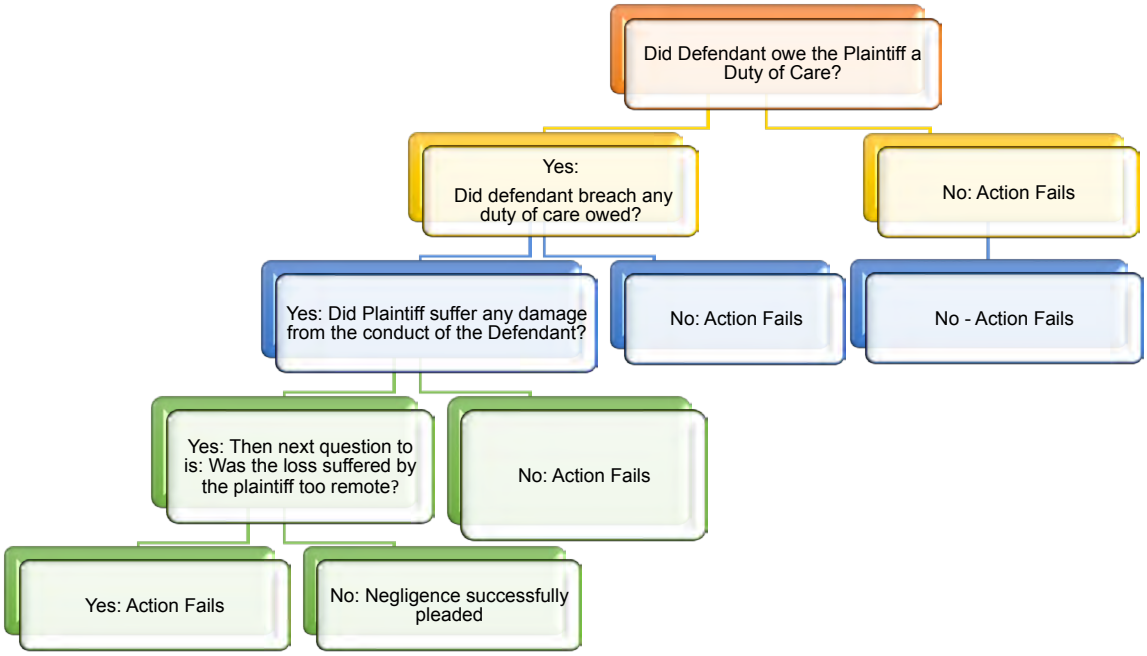


Figure 4.1 Summary of Elements of Negligence

4.1.1 Duty of Care

The '*neighbour principle*' as formulated by Lord Atkin in *Donoghue v Stevenson* [1932] (*the 'Snail in the bottle' case*), outlined the situations when a duty of care may arise. In ascertaining whether a duty of care exists, the first question that has to be determined is whether the defendant (commonly referred to as the '*tortfeasor*') actually owed the plaintiff a duty to take '*reasonable care*'. The law states that generally a defendant owes a legal duty of care in situations where it is reasonably foreseeable that their conduct, including failure to act (omission) would have caused harm to the plaintiff and the defendant had a direct and 'controlling 'position over a 'vulnerable' plaintiff. The determination of the duty of care is a question of law that is determined by the Judge in the given situations involving various categories of duties to reflect changes in the law and society since the introduction of the '*neighbour principle*' in 1932 arising from the case of *Donoghue v Stevenson* [1932] AC 562 (also gave rise to the duty of care of manufacturers).

In any negligence action it is important for the court to determine if a duty of care is owed to the plaintiff, because it depends on what types of damage will be awarded to the successful plaintiff. The determination of the duty of care involves an objective test of the 'standard of care' of a reasonable person and a test of foreseeability, which was is illustrated by *Hay (or Bourhill) v Young* [1943] AC 92 and *Bolton v Stone* [1951] AC 850. This case highlighted the issue of whether it was reasonably foreseeable that the actions or conduct of the defendant would affect the plaintiff in a manner that would harm, injure or damage the plaintiff in any way. Apart from the test of foreseeability and previously the proximity test (which has been replaced by the control and vulnerability test in the 1990s), the scope of liability has been narrowed by the courts since the case of *Jaensch v Coffey* (1984) 155 CLR 549.

Consequently, the other tests that the courts now use to determine if a duty of care existed and was breached includes the issue of 'control and 'vulnerability' between the plaintiff and the defendant as well as other legal policy considerations that may arise in the given situation which is a matter of law to be determined by the judge. It should be noted that in some situations a plaintiff may argue that they are not required to establish or prove duty of care as the facts alone as they stand can prove negligence and they base their claim on *res ipsa loquitur*, that is, 'the facts speaks for themselves'.

4.1.2 Breach of Duty of Care

Negligence as outlined in *Blythe v Birmingham Waterworks Co* (1895) 11 Exch 781 at 784 per Alderson B, defines negligence as follows:

> *'Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs would do, or something which a prudent and reasonable person would not do'.*

When the plaintiff to the satisfaction of the court has established that the defendant did owe him or her a duty of care, which is a question of law decided by the Judge, the plaintiff then has to establish that the defendant breached that duty of care. Under the common law the defendant fails to satisfy the required standard of care if the risk of injury was reasonably foreseeable and the defendant failed to do what a reasonable person would have done in the given circumstances. If a successful action in negligence is to be established by the plaintiff then each of these requirements must be satisfied otherwise the defendant will not be liable. In determining whether the defendant breached the duty of care there is considerable overlap between the issues of duty of care and the required standard of care.

The appropriate question, in the context of determining breach of duty, is *'Did the defendant take reasonable care?' Did the defendant observe the standard of care required of them on the given facts?* The answers to these two questions are ascertained by reference to *what is reasonable in the given circumstances*, that is, the reasonable person test is applied and connected with the required standard of care that would have been expected in the given circumstances. There is generally significant overlap between the issues of duty of care and standard of care which has to be determined by the Judge and is often a question of law for the Judge to decide from the given facts.

In determining whether there has been a breach of the required *standard* and duty of care that were reasonable in the given situations the courts take into account a number of factors, among other relevant things, in determining whether a reasonable person would have taken precautions or other reasonable measures against a risk or harm which are looked at together in order to establish liability of the defendant. Apart from the 'reasonable person' test other factors that the courts will consider to ascertain whether there has been actual breach of the duty of care includes the following, the:

- probability (likelihood) of harm;
- gravity (likely seriousness) of harm;
- degree or effort (burden) required to eliminate or avoid the risk of harm; and
- social utility or benefit of the defendant's conduct causing the harm.

4.1.3 Damage Suffered

In general terms the issue of damages is linked with the concept of 'duty of care' and the 'standard of care'. They are important concepts as they are concerned with determining the type of plaintiff that will be compensated and for what kinds of damage, as well as the types of defendant's and their conduct. The issue then is how are these things that determine damage in a cause of action in negligence linked or connected to ensure that the appropriate and desired outcome and recovery is achieved and obtained for both the plaintiff and the defendant. The issue of question of damages is connected by the issue of 'causation' and formerly 'remoteness of damage or proximity (closeness)' which has now been replaced by the 'control and vulnerability test', which are crucial to any legal issue involving an action in negligence

4.2 Causation

In respect to determining whether a breach of the duty of care that was owed by the defendant to the plaintiff actually caused the harm, injury or loss two elements in respect to ascertaining causation have to be determined which include factual causation and the scope of liability (or attributive causation) which are essential in ascertaining whether the breach actually caused the damage and was reasonably foreseeable based on the standard of the reasonable person.

4.2.1 Factual Causation

This type of causation is important in determining if the Defendant had acted carefully and took reasonable care would the Plaintiff have suffered the particularly loss complained of, that is did the Defendant actually cause the harm.

4.2.2 Scope of Liability

This test in ascertaining the causal link and scope of liability of the defendant is important in determining the appropriate scope of the negligent person's liability, to the actual and direct harm caused and ensuring that it is not too remote. In order to satisfy the first requirement of causation in an action in negligence, it is also necessary to consider whether the defendant's negligence was a necessary condition of the harm or damage actually taking place and causing the harm, loss or injury to the plaintiff.

4.3 Remoteness of Damage

Apart from causation the courts also recognise that sometimes the defendant cannot be held liable for all of the plaintiff's damage, harm or injury that arises from the negligent action. Accordingly the issue of remoteness of damage (proximity) is important as it focuses on consequences giving rise to the damage and in this way some limitation is placed on the extent of the defendant's liability. This test is used to establish if there was a sufficiently close connection between the plaintiff and the defendant and gives rise to the control and vulnerability test. However, in some situations such as in establishing economic and financial loss the proximity test may also be used to establish damage as a result of the breach of the duty of care. A defendant will not be liable for damages that the court considers to be too remote. In these instances the courts will apply the test of reasonable foreseeability to determine whether the particular damage complained of was actually foreseeable in the particular circumstances surrounding the case.

Thus, to succeed in his action for damages, the plaintiff must show that the damage was a foreseeable result from the actual Negligence of the Defendant, that it was not remote and that the particular type of injury, loss, harm or damage suffered was foreseeable by the 'reasonable person'. The leading case in respect to the basic test of remoteness of damage and to what extent a defendant is held liable and responsible for the direct consequences of their negligent act, conduct or misconduct is *Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound No 1)* [1961] AC 388.

4.4 Damages

The issue of damage is vital and central to an action in negligence. To succeed in such an action the plaintiff has to show that actual loss and or actual damage arose as a direct result (causation) of the defendant's breach of the duty of care that was owed in the given circumstances. Also the damages or loss complained of must be of type that is recognised by the law as is illustrated by *Cork v Kirby Maclean Ltd* [1952] 2 All ER 402 and the *Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound No 1)* [1961] AC 388. In a negligence action damages in the form of monetary compensation by the plaintiff may be sought for the following:

- Economic or financial loss or damage, such as lost or missed sales;
- Damage to property caused by faulty equipment or defective structures, and
- Actual damage to the person arising from a motor vehicle accident or psychological damage.

It should be noted that not all types of damage is recoverable in a negligence action. These types of damages that are not recognised by negligence includes damages that arises from criminal or fraudulent activities, where the type or nature of the damage is unclear and even harm to reputation where an action in defamation would be sought. To succeed in an action in negligence and to sue for damages, the plaintiff must first establish on the balance of probabilities (civil action) that the conduct or activity of the defendant actually caused (causation) the plaintiff's personal injury, harm, damage or loss.

4.5 Reasonable Person

A reasonable person is described as a person who possesses the faculty of reason and conducts himself or herself in accordance with the standards of society at the time. Therefore, the reasonable person is someone of normal intelligence and knowledge who can perceive the surrounding circumstances in such a manner and mental capacity to be able to determine right and wrong, which is expected of a reasonable person in the particular circumstances. If a person possesses a particular skill, then that person is required to show the skill that is normally possessed by persons claiming such a skill and must satisfy the standard of care of a reasonably skilled and competent person in that field or practice. In this regard the law requires the person to whose the expected 'reasonable skill' as an ordinary member of the profession to which they belong would normally show.

Thus people with special skills or knowledge must meet the requirements of the reasonable standard of care that is expected from competent persons in their field, such as for example accountants and auditors. The standard of care that is expected of the reasonable person is actually determined by the nature of the relationship between the parties and relevant personal characteristics of the defendant's age, mental stability and skill. In negligence actions this requirement of 'reasonableness' has contributed significantly to the flexibility in the negligence action as it allows courts to make social judgments that are relevant to the society at the current time within the law-making process.

4.6 Standard of Care

The standard of care refers to the level of 'care' that is expected of a reasonable person (of normal intelligence) who is equipped with the same skills and expertise as a person who works in a particular trade or profession. In respect to the standard of care, in some cases it can be reduced and in respect to trainees in any profession or trade they are only expected to satisfy the standard of care that is reasonably expected in accordance with their level and skill. Any person that falsely claims that they are fully competent are generally judged against the standard of the 'reasonably competent' professional in that particular trade or profession. This means that the standard of care and conduct that is expected of the reasonable person is determined by taking into consideration the nature of the relationship between the parties and the personal characteristics of the defendant, including the defendant's age, mental capacity and stability and skill. This important aspect of the standard of care in respect to the tort of negligence is illustrated by Figure 4.2 Standard of Care and Figure 4.3 Standard of Care and Conduct

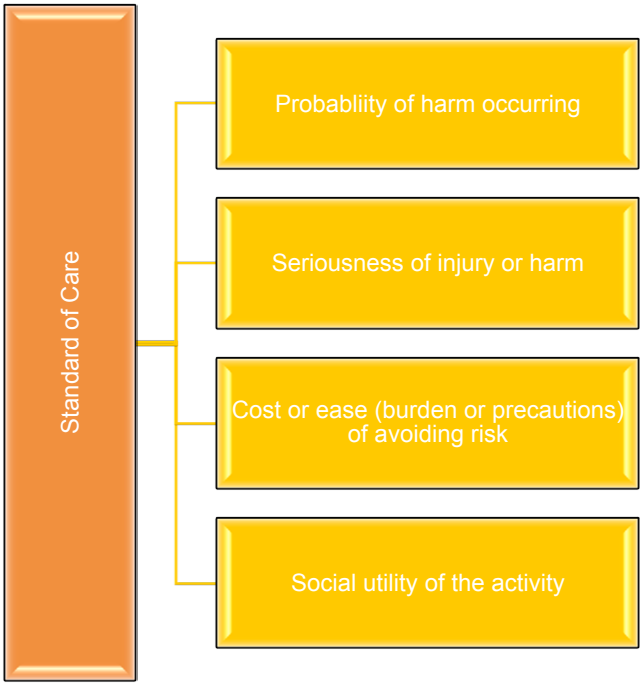


Figure 4.2 Standard of Care

In some situations a lesser standard of care is accepted such us in respect to trainees as well as in respect to a child as their conduct will be based against what a reasonable child of similar age and experience would have done in the given situations. The standard of care varies from one situation to another and is not static but flexible to ensure fairness and consistency in the outcome of civil law cases but in situations of special knowledge and skills there is a higher standard owed, as opposed to a lower standard especially in respect to children. In respect to children the reasonable person test is altered as children are deemed to be not as capable as adults to look after themselves and accordingly the standard of care changes to that of a child of similar age and experience.

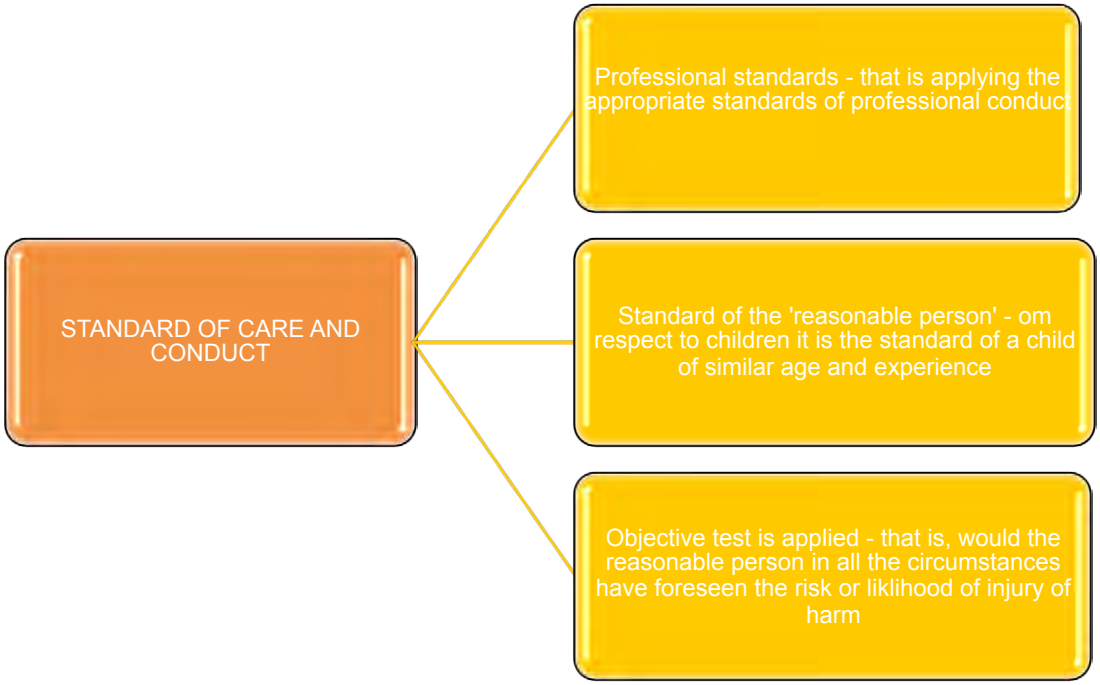


Figure 4.3 Standard of Care and Conduct

4.7 Vulnerability and Control Tests

In respect to the issue of whether a duty of care was owed the vulnerability fundamentally replaced the *proximity* test the courts have established broader tests in an attempt to protect 'vulnerable' plaintiffs who were not aware of the risk created by the defendant, who may have 'controlled' them in some way and they were unable to protect themselves, even if they had been aware of the potential harm, injury or damage. In the consideration of whether there was a 'vulnerable' relationship between the parties the courts will take into account the following three factors:

- Was the defendant in a controlling position of the plaintiff and was the defendant aware of this ability of control, such as doctor and patient?
- Was the plaintiff reliant on the defendant such as accountant and client?
- Was the defendant in such a position that required them to be protective of the plaintiff such as parent and child or teacher and pupil?

Apart from these three factors to determine whether the duty of care that was owed was breached the courts sometimes consider whether the imposition of a duty of care in the given circumstances was fair, justifiable and in the interests of the public. If any of these factors are satisfied then the plaintiff may be able to succeed in an action in negligence for breach of the duty of care that was owed to them in the particular circumstances.

4.8 Policy Considerations

If the three factors that are considered in determining vulnerability are answered positively, it may mean that the Court will determine that the defendant should not be held liable to the Plaintiff. In this regard the Courts will take into account policy considerations which are based on value judgments such as fairness, justice and consideration of whether a duty may lead to unlimited liability due to the issue of 'proximity'. In the case of *Hay (or Bourhill) v Young* [1943] AC 92, a driver who negligently hit a motorcyclist was also liable for the nervous shock suffered by the victim's wife when she saw her husband's injuries in hospital. As there has been some problems with the application of the *'foreseeability'* test especially in respect to ascertaining economic loss, the concept of proximity has been used in some instances in order to limit liability of the defendant. Accordingly, the as there is not one specific and acceptable test for duty of care, in recent years there has been a judicial preference for an *incremental response* to the issue of negligence in unusual situations giving rise to financial and economic loss, such as occurred in the case of *Perre v Apand Pty Ltd* (1999) ALJR 1190.

This broad '*proximity*' 1943 test has since been rejected in some common law jurisdictions as the courts now contend that the outcome of this case in *Perre v Apand Pty Ltd* (1999) ALJR 1190 would be more applicable as a matter of new law. In this case the defendant was liable for economic loss to farmers who were prevented from selling their crops and not just limited to the farmer who had received the diseased potato seed because in this instance the defendant negligently introduced a trial plating of bacterial wilt that led to the destruction of the commercial potato crop. In summary the new development in respect to the search and effort to limit liability is summarised below:

DUTY OF CARE
Reasonable Foreseeability
Comparable to other cases of recognised duty of care, such as *Donoghue v Stevenson* [1932] AC 562 (UK) (manufacturer) that was later adopted and approved in *Grant v Australian Knitting Mills* (1935) 54 CLR 49 (wholesaler).
Main features aim to duty of care
Other necessary policy considerations, such as in relation to problems with foreseeability and economic loss

4.9 Probability of Harm

If the risk is small and a reasonably careful person would not worry about it then the Defendant is not liable if a person is injured. This factor as well as the issue of foreseeability of risk of injury and precautions is considered in the case of *Bolton v Stone* [1951] AC 850. In this case the House of Lords held that the defendant was justified in disregarding a foreseeable risk of injury where there was only a remote chance of being hit by a cricket ball while walking past the defendant's cricket ground and one that a reasonable person would ignore and the defendant were not liable. Under, civil liability provisions there is a duty to warn others of any obvious risk, including those with a low chance of risk taking place.

4.9.1 Seriousness of Harm

If the plaintiff is engaged in activities that are dangerous or has a condition that makes them more vulnerable to harm or injury, a higher standard of care is generally imposed by law. This factor is considered objectively by referring to the particular circumstances of the case and it is highlighted by *Paris v Stepney Borough Council* [1951] AC 367, a case that was concerned with the issues of tort, negligence, duty of care, reasonableness of precautions and special duty of care.

4.9.2 Avoiding Risk of Harm

In order to take precautions to avoid the risk of harm the onus is on the plaintiff to identify the precautions that the defendant should have taken, and then show that the burden of the cost, difficulty and inconvenience was not unreasonable. The gravity of the risk and likelihood of injury have to be outweighed against the expense, difficulty and inconvenience of any action that is necessary to reduce the risk. In other words, exonerating factors take into account broad categories of social utility and the *cost of prevention*, that is the burden of *eliminating the risk or harm* and the objective test that is used is that of the reasonable person.

4.9.3 Benefits of Harm Minimisation

This factor refers to the idea that some activities are more worth taking risks for than others such as playing sports which has direct benefits to the individual and the wider community. Any type of sports carries a higher risk of injury to a participant than to someone who does not play sports, and accordingly the benefits have to be weighed against the costs and decisions made accordingly on what can be done to minimise damage or injury, such as erecting fences on sporting grounds.

4.10 Defences

In order for a plaintiff to succeed in fully recovering for the loss, harm, damage or injury caused by the defendant in an action in negligence, it is essential that there is no conduct by the plaintiff that the defendant can raise which may be prejudicial to the case thus, limiting or reducing liability. Until recently, negligence law only developed through the common law cases and through precedent. However, due to the complexities of tort and negligence in general and society becoming very litigious and to ensure that only genuine cases are heard in the courts most nations have passed civil liabilities legislation to assist in determination of civil disputes. The two main defences that can be raised by a defendant in an action in negligence against the plaintiff are, voluntary assumption of risk (*volenti non-fit injuria)* and contributory negligence.

4.10.1 Voluntary Assumption of Risk (*Volenti non-fit injuria*)

The Latin term *volenti non-fit injuria* means that 'he who consents is not injured'. The Courts have narrowed the scope of this defence which means that to succeed in raising this defence the defendant must show that the plaintiff knew of the risk and the nature and extent of the risk and accepted it willingly. If raised successfully by the defendant, voluntary assumption of risk (*volenti non-fit injuria)* is a complete defence.

4.10.2 Contributory Negligence

Contributory negligence on the part of the plaintiff involves the failure by the plaintiff to take reasonable care and precautions for their own safety. If the person accepts a lift from a drunken or intoxicated person he or she is partly to blame if the driver has an accident causing them injury.

In most common law and civil nations today, due to much needed civil law reforms, statute law now provides for an apportionment of damages where a person suffers damage partly as a result of their own negligence and the negligence of another. These statutes are applied in determining contributory negligence, and enable the courts to partially compensate those plaintiffs who contributed in some way to their loss, harm or damage. Contributory negligence must be proved by the defendant.

To determine whether a plaintiff has contributed negligently to the loss or damage suffered, the standard of care is based on that of a reasonable person in the position of the plaintiff and the matter will be decided on the basis of what the person knew or ought to have known at the time. The apportionment of damages awarded by the court is based on what is fair and reasonable under the circumstances between the parties as dictated by general law as well as any enacted legislation governing the defence of contributory negligence to deter and minimise any abuse of this area of negligent law.

4.11 *Res ipsa Loquitur* ('the facts speak for themselves')

Res ipsa loquitur is a rule of evidence that allows the plaintiff to treat the actual facts as evidence of the defendant's negligence. This rule is often used when the plaintiff is unable to obtain primary evidence as it may be in the possession and control of the defendant to support the negligence. In this instance the plaintiff claims that the mere fact that the negligence occurred clearly indicates that the defendant is at fault and under general civil liability laws and the heavier burden or onus of proof is on the plaintiffs. In order for this rule of evidence to operate and support the plaintiff's action in negligence the following three conditions must be satisfied:

- The Plaintiffs injury was one that ordinarily would not happen if proper care had been taken; and
- The Plaintiff was injured by something within the exclusive control of the Defendant; and
- There is an absence of explanation and no scope for inference.

Key Points

Key points in this module are:

MO1: **Explain the meaning of Negligence**: Negligence is the omission to do something which a reasonable person would do, or doing something which a prudent and reasonable person would not do taking into account their surroundings and circumstances. This Negligence is an actual failure to exercise reasonable care and skill based on the standard of the reasonable person.

MO2: **Identify the elements that are necessary in order to establish a case in Negligence**: In order to be successful in a negligence action, the injured party (plaintiff) must establish on the balance of probabilities (civil action) that the person who caused the injury or harm (the defendant) owed them a duty of care, there was a breach of that duty of care and that as a result of that breach, they suffered actual loss or damage that is recognised by law.

MO3: Explain when the defendant owes a duty of care to the plaintiff and the tests that must be established by the courts in their determination of whether a duty of care exists: Under the general law there is a duty owed by the defendant to the plaintiff and it is based on the direct relationship between them, that is, that as a result of that close relationship there is a foreseeable risk of injury as a consequence of the breach of the duty of care and it must be established to the satisfaction by the judge in a court of law. The basis of the approach to the question of the actual existence of a duty of care today is also determined by the application of the 'foreseeability' test, whether there was a vulnerable or dependency relationship between the defendant and the plaintiff as well as taking into account any policy considerations. The test of proximity within a negligence action has not been totally rejected due to the prominence of the foreseeability and vulnerability tests used by the courts, but it continues to be relevant in certain areas of negligence actions involving economic loss and mental harm.

MO4: **Explain when there is a breach of duty of care that was owed by the defendant**: In ascertaining whether there has been a breach of the duty of care that was owed in particular situation, there are two tests that need applied and satisfied. Firstly, it is necessary to determine whether or not the risk of injury or harm was reasonably foreseeable. A person is not negligent by failing to take precaution against a risk of harm, unless there was a real and genuine foreseeable risk, and the risk was not insignificant in those circumstances, and wherein a reasonable person in the position of the defendant would have taken precautions to minimise (mitigate) the harm. Secondly, the court would also take into consideration in determining if a duty of care was owed by taking into account the following factors, namely, the probability that the harm would have occurred if care and been taken, the likely seriousness of the harm (objective test taking in to account the circumstances of the particular case), the burden of taking precautions to minimise (mitigate) the risk of harm and the social utility of the activity that caused the harm.

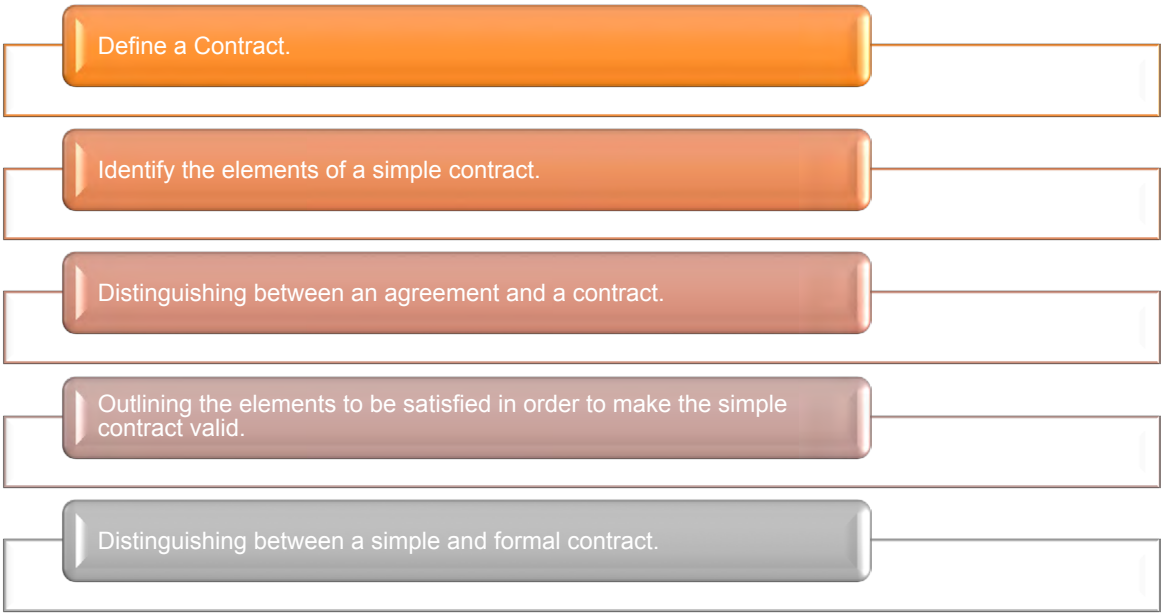
MO5: **Explain whether the plaintiff has suffered recoverable damage from the negligence action**: Under negligence the damage that arises may be economic, to property or to the person, but there must in all instances be actual damage that must be recognised by law and gives rise to two more questions that need to be proved by the plaintiff on the balance of probabilities (civil action). Firstly, the courts need to establish whether there is and actual relationship between the defendant and the plaintiff and whether the loss or damage to the plaintiff 'directly caused' by the defendant's lack of care and breach of their duty of care (causation); and secondly, the issue of remoteness must be determined in establishing whether the defendant could have reasonably foreseen that kind of loss in the particular circumstances.

CO6: **Explain what defences a defendant is able to raise in a negligence claim**: Under the general law, the two main defences that are available to a defendant in a negligence action are contributory negligence which will operate to reduce the quantum of damages and voluntary assumption of the risk which is as total defence and for which no damages can be claimed.

Module 5 Contract Law

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Consideration: May consist either in some right, interest, profit or benefit accruing to the one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other, or an act or forbearance of one party, or the promise thereof, which is the price for which the promise of the other is bought, and the promise thus given for value is enforceable.

Consumer: A person is deemed to be a consumer if they acquire goods or services in a transaction with a specific threshold, such as $40,000 for personal or domestic use and they are not used in business or resold or transformed in the course of a process of manufacture or production.

Contract: An agreement that gives rise to legal rights and obligations between parties to it and that will be enforced in a court of law.

Contract for the sale of goods: In sale of goods legislation, a contract whereby the seller transfers, or agrees to transfer, the property in goods.

E-Commerce (Electronic commerce): commerce by means of the computer, the Internet and other telecommunications links such as electronic data exchange (EDI).

Key Cases

Central London Property Trust Ltd v High Trees House Ltd [1947] KB 130
Commonweatlh v Verwayen (1990) 95 ALR 321
Giumelli v Giumelli (1999) 190 CLR 101
Jorden v Money (1854) 5 HL Cas 185
Legione v Hateley (1983) 152 CLR 406
Walton Stores (Interstate) Ltd v Maher (1988) 164 CLR 387.

Contract Law

The importance of contract law in business and commercial life cannot be covered adequately as the landscape changes to keep abreast of technology changes and globalisation making it difficult to define exactly what the Law regards as a 'contract'. People and businesses enter into a myriad of contracts every day, covering the daily essentials of living, such as food and transport or entering into contracts for larger purchasers such as a house. The law of contract pervades every facet of our daily lives and forms the basis of all commercial or business transactions from buying a bus or train ticket or when making purchases online via the Internet. Contracts are a very important part of trade and commerce and are vital to doing any form of business locally, nationally or internationally.

Contract law in is generally derived from a number of sources which are either based on the common law legal system that was inherited and adopted from England in most common law legal systems or from the codes of civil law code legal systems. Contracts are constantly being entered into by individuals and individuals and businesses to sell or transfer property, leasing of premises and hiring of employees, locally, nationally and internationally. A legally binding contract is distinguished from other agreements or promises because the contract is enforceable in a court of law if the terms and conditions are not complied with by one of the parties to the contract.

5.1 Nature of a Contract

The law of contract is a branch of civil law (citizen v citizen) instead of criminal law (state v citizen). Civil law differs from criminal law because the main aim or purpose on which an action for breach of contract is based on is to compensate the plaintiff, the party brining the action for any loss incurred as a result of the breach by the defendant. In the event of a breach of a contract between the parties, the main aim of contract law (civil action) is to compensate the plaintiff for losses as a direct result of the breach of contract and not to punish the defendant which is the main objective under criminal law.

The main remedy sought for an action for breach of contract is an award of the common law remedy of damages, being monetary compensation for the loss sustained as a direct result of the breach. However, in some instances, the plaintiff may not want to obtain compensation by way of damage, but instead may want to compel the defaulting party (defendant) to perform the promises in the contracts, the duties and obligations under the contract. In this instance, the courts may make an order for the equitable remedy of specific performance (forcing the party to perform their part of the contract) or grant an Injunction (to stop a party from performing under the contract).

A contract is an agreement in which there was actual intention to create a legally binding and enforceable agreement forming the contract. Accordingly, agreement depends on a promise that is made by one party to the other, but not all promises or agreements create legally enforceable and binding contracts as is illustrated by Figure 1 Nature of a Contract. A contract is distinguished from a mere an agreement between the parties because it is a type of agreement which the courts will enforce that are deemed to exist between the parties or by operation of the law. Courts therefore will only enforce agreements which are intended to have legal force if the parties do not perform their promises under the contract and may be liable to pay damages for *breach* of their contractual obligations.

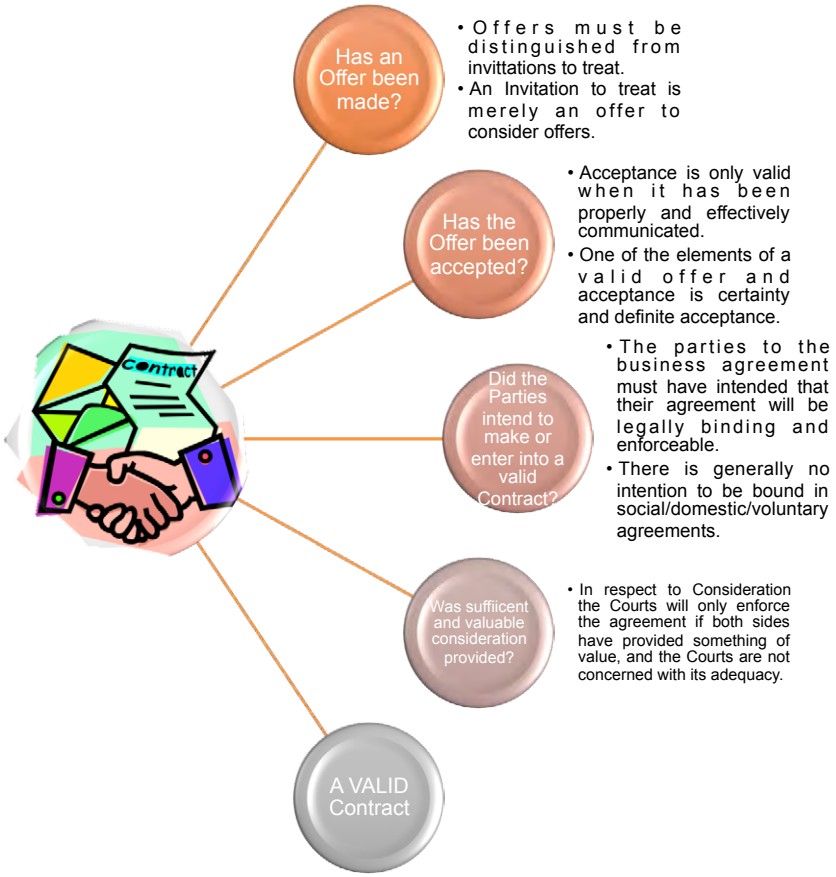


Table 1 Nature of a Contract

Contracts may be created orally, written of a combination of the two and be even arise from previous dealings and conduct. The legal enforceability of contracts both traditionally and those formed via the Internet such as on e-Bay is of vital importance to the parties to the contract because if a dispute arises, the contract will be relied on by either of the parties.

In respect to a contractual dispute only parties to the contract (*privity of contract)* are able to enforce rights and obligations under the contract that may have been formed orally or in writing or by implication. Some contracts are more complex than others such as mergers between two multi-national companies or banks, some contracts occur immediately such as when purchasing a bus or train ticket while other are for a longer term such as a mortgage.

However, regardless of how large or small, all valid contracts must first satisfy all of the essential elements in order for them to be legally enforceable. Business is primarily concerned with creating and forming business or commercial relationships with one type or another. For example, the producer or manufacturer of goods must find a distributor and the retailer must find customers. These business or commercial relationships ultimately give rise to legal rights and obligations which are determined by the law of contracts governing a wide spectrum of transactions for goods and services.

5.2 Promises in Contracts

The main purpose or aim of the law of contract is fundamentally to determine the circumstances under which people are legally bound by the *promises* that they made whether intentionally (expressed) or unintentionally (implied). In contract law a promise is vital to the issue of intention and enforceability and it is seen as a genuine commitment by a person that something will or will not take place. The person making the promise is called the promisor and the person to whom the actual promise is made is called the promisee. The law presumes, that the parties to a business (commercial) agreement actually intend to create legal relations and that they will be legally bound by their promises unless the presumption is rebutted. However, if the parties in a business agreement did not intend the agreement to be legally enforceable then, this must be proved in court.

Despite this, the courts do not always enforce all promises merely because they are business agreements. This is because there is a significant difference in law between a promise, an agreement and a legally enforceable and binding contract. A promise can be made by one party. However, an agreement requires a 'meeting of the minds' of two or more parties. To be valid and legally enforceable a contract requires more than just agreement and requires: agreement, intention to be legally bound by the agreement and a bargain, called consideration as illustrated by Figure 6.1 Elements of a Simple Contract.

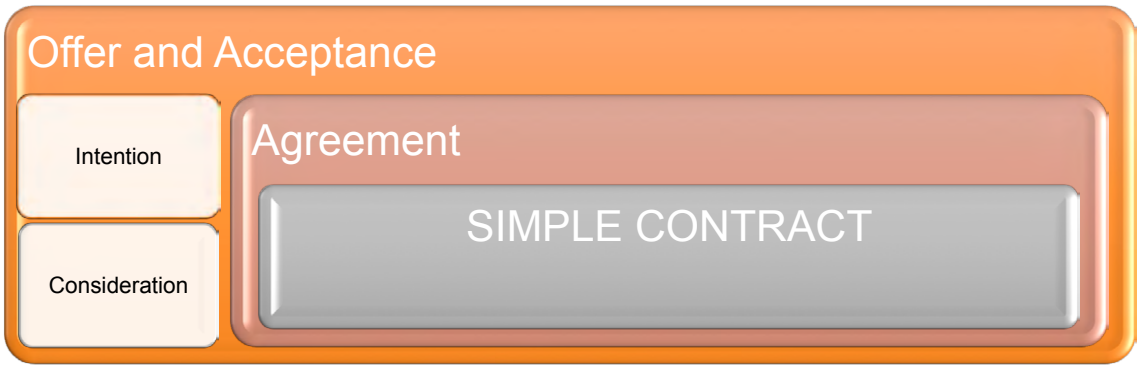


Figure 6.1 Elements of a Simple Contract

In order for a valid contract to exist that is enforceable in a court of law, the promise or promises made between the parties must have been genuine and based on real intention and all of the essential elements of a valid contract must be satisfied, if not, there is no valid contract between the parties. Essentially the agreement that gave rise the agreement must contain a promise. In the legal sense a promise is a commitment or undertaking made by one person to another that something will be done or not done in the future. In respect to the law of contract the person who made the promise is called the promisor (promises to do something or refrain from doing something), and the person to whom the promise is made is known as the promise.

These types of promises are entered into everyday by people sometimes voluntarily such as making an appointment to see someone, to lend money or involuntarily such as obeying certain rules or making purchases with certain conditions and terms attached which may or may not be obvious at the time of entering into the agreement that becomes a contract based on the promise. In respect to contracts it is necessary to determine the nature of the promise and whether or not it was meant to be contractual as there are serious consequences for failing to perform or carry through with the particular promise that gave rise to the legal obligation.

5.3 Contract and Agreement Distinguished

In respect to the formation of valid contracts, *all* contracts are actual agreements which have been intended to create legal relations, but it does not always mean that all agreements between parties form or create valid contracts. Each day people make agreements for all sorts of reasons and in various ways, and some agreements by their very nature are intended to be legally binding and enforceable in a court of law (business or commercial agreements) while others are not intended to give rise to such legal consequences (social, domestic or voluntary agreements). Consider the following situations: *Anton agrees with Larry to go to the movies and Chris offers his son Anton $1,000 to do well in his University Studies. These are in fact agreements between the parties, but do they constitute a valid contract?* The logical conclusion is that the parties would have not intended that these agreements would give rise to any legal consequences and are merely 'agreements'. They are not contracts as none of the elements of a valid contract can be established from the given facts, and it is clear that the parties did not intend to create any legal obligations or rights under the agreements which distinguish them from contracts, as is illustrated Figure 6.2 The Nature of an Agreement.

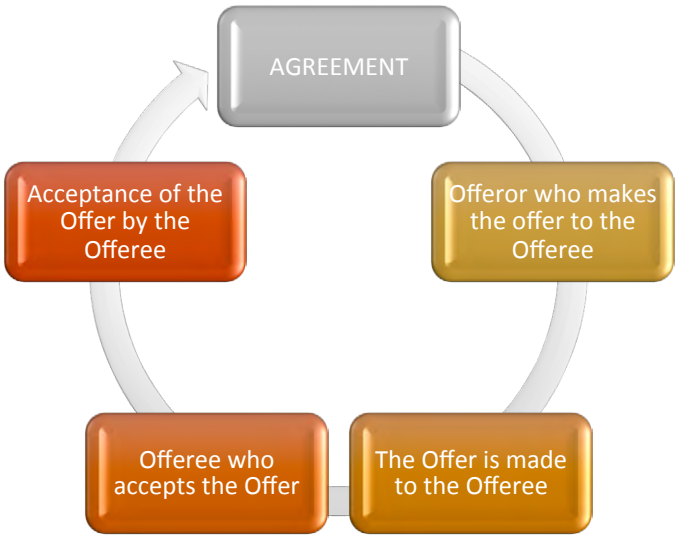


Figure 6.2 The Nature of an Agreement

5.4 Privity of Contract

The legal enforceability of contracts is vital and of paramount importance to the parties entering into the contract. This is because if a dispute arises, the contract whether in oral or written form, will no doubt be relied upon by either party. Accordingly, only parties to the contract are 'privy' to the legal agreement because they have their legal rights and obligations which they intend to be legally bound expressed in the contract which is enforceable under the law.

Privity of contract therefore, refers to the principle that restricts the rights and obligations of a contract to the immediate parties who have entered into the contract. This means that only a party that is *'privy'* to a legal contract can sue and be sued, and any person that is not a party to the contract such as a third party, cannot sue for any benefits or rights under the contract to which they are not a party. The exclusion of third parties to a contract is at the core of the 'privity of contract' doctrine and is closely linked with the requirement that consideration, the third vital element of a valid contract must flow from the promisee.

The main reason for this essential requirement is because generally a third party has not provided any form of consideration at the time that the contract is formed and hence does not acquire any rights or obligations under the contract. There are a number of criticisms of the doctrine of privity as it has serious and often harsh commercial consequences for third parties who rely on the expectation that a benefit will be given to them under the contract. This issue has caused many problems regarding whether the need for consideration to support a promise under a contract and the doctrine of privity of contract are interrelated or whether they should be treated a separate and distinct rules.

In order to overcome this complexity and to enable commercial viability there are a number of exceptions to the privity of contract rule. These exceptions have been developed in order to override the privity of contract rule because the courts felt that it was necessary in order to prevent any injustice and unfairness to a third party that relied on an expected benefit under the contract. Essentially the courts have allowed exceptions to the privity of contract rule in respect to trusts, joint promises and agency.

5.5 Elements of a Valid Contract

In order for an apparent simple contract to be valid, binding and enforceable in a court of law the following elements must be present:- an offer and a corresponding acceptance (the agreement); intention to create legal relations; consideration; legal capacity; genuine consent; legality of contract and form. All of these elements must be present before a valid and binding contract can be created or formed and if any of these elements are missing then there is no valid contract. If any of the elements are missing then the contract may be unenforceable and may be set aside by the court returning both parties to their former position and relieving them of any obligations and rights.

5.6 Damages for Breach of Contract

Under the common law, any breaches of the terms of the contract enables the plaintiff who may have sustained economic, personal or expectation losses for the defendant's failure to act and or perform under the contract and who is in breach of the contract, to sue for damages. The plaintiff will ordinarily seek monetary compensation, remedy for damages, on the basis that in most instances the breach that has occurred can be adequately compensated by way of monetary compensation.

In situations where monetary compensation is not the appropriate remedy or the actual remedy sought by the plaintiff, then alternative remedies will be available under equity for either an Injunction to stop the performance or an order for specific performance to compel the defaulting party to perform under the contract thereby ensuring justice under the circumstances for the plaintiff. The main aim of monetary compensation where there has been a breach of the terms of the contract is to compensate the plaintiff for actual loss by awarding damages.

Under contract law damages are not awarded to punish the wrongdoer, but instead the main purpose of awarding damages is to put the injured party, the plaintiff, back in the position that he or she would have occupied if the contract had actually been carried out and performed as had been intentionally agreed to by the parties. Damages under the common law are calculated on the basis of looking at what the position should have been if the contract had been properly performed and no breach had taken place.

If the court establishes that the plaintiff is entitled to monetary compensation (damages) then the type of damage that will be awarded has to be determined from the given circumstances. The types of damages that can be awarded to a successful plaintiff are:

- Nominal damages where no actual loss suffered, but legal rights have been infringed.
- Ordinary or real damages which is the usual remedy in contract law and is the amount awarded by the court on its assessment of the loss suffered by the plaintiff as a result of the breach.
- Exemplary damages that are generally not awarded in contract but under tort in order to punish (fine) the defaulting party.

5.7 Sources of Contract Law

Historically, the original source of the law of contract was derived from the law the evolved over the centuries from the English common law courts that were subsequently inherited in other common law nations as well as in civil legal systems. The many legal principles, rules and cases that have evolved in English common law courts are still relevant and are applied in the law of contract today. Even though there are substantial international cases in this area of the law, nevertheless the English decisions are still significant and have been applied satisfactorily by judges in making decisions regarding a contractual dispute. In order to ensure that the law of contract is relevant in today's complex and modern commercial environment where contracts are created daily in various forms personally and online, parliaments have enacted sales of goods and consumer protection legislation. This legislation have had significant impact on a large number of businesses and enterprises to ensure that the terms are clearly stated in order to protect the parties involved in particular types of contracts where there may be an unequal bargaining position.

Examples of such types of contracts which are now also regulated by the general law as well as statute (common law legal systems) or codes (civil code legal systems) include among many others:

- all types of sales of goods and consumer transactions;
- contracts of employment;
- commercial and residential tenancies;
- sale of land contracts (real estate);
- partnership and business contracts;
- agency law and powers of attorneys; and
- financial products and prospectuses.

In most nations however, irrespective of the type of legal system, the main source of contract law is obtained from the following: common law principles (judge made/case law-precedent); equitable principles (judge made or case law-precedent) and statute law (Acts or Legislation) (laws made and enacted by parliament).

5.8 Common Law Principles

In respect to the principles of common law that apply to contract law they have evolved through the ages and in today's modern world they are still vital and provide the fundamental basis upon which a contractual issue or dispute is resolved. "Common law" has two main meanings:

- Traditionally it is the law that is made by the judges in the common law courts that is distinctly from the law that is made in the courts of equity or under statute law. The common law as it exists today has developed through the operation of the doctrine of precedent, which means that similar decisions will be followed by other judges as authority in subsequent or similar cases.
- In a broader meaning it refers to the entire legal system of England which has been adopted by many countries that were colonised by England. In this sense, 'common law' refers to the common law legal system as distinct and separate from the Roman or civil law legal system that is prevalent in European countries.

The common law principles are vital and provide the basis to any system of law as it promotes among other important aspects such things as uniformity of laws; certainty of laws; consistency of laws; and fairness and justice. Also the doctrine of precedent ensures that the decisions are in fact consistent so that all persons in similar situations were treated in the same fair manner. For this purpose, the common law provides a forum through the appeal system to ensure that all decisions are made properly and to overturn any incorrect decisions of the lower courts and to adjust or correct any inaccurate, arbitrary, or improper exercise of power by judges.

At common law the same legal principles apply to all the different types of contracts large and small that are made daily between individuals and organisations. In respect to contract law the equitable principles in equity which supplements the common law operates to alleviate an absurdity or harshness if the parties are compelled with to comply with for example harsh and onerous terms. Statute law has over the years changed the basis of the application of the common law principles especially in respect of contracts involving those businesses that supply goods and/or services to consumers. Contract law is a branch of civil law and is based on the implied right of freedom to contract with anyone and accordingly, most of contract law is based on the principles that underpin the common law legal system, such as established cases and precedent.

5.9 Equitable Principles

"Equity", means to be fair and just and refers to the branch of the law that was developed in the courts of equity to supplement the common law. The law of equity evolved as there were obvious deficiencies in the common law which became rigid and inflexible because judges adhered rigidly to the laid-down law and rules of procedure. Essentially the main difference between the common law and equity lies in the remedies that are available. Under the common law the main remedy is damages, being monetary compensation whereas in equity the remedies are discretionary, such as the granting of an injunction (to stop) or specific performance (to compel performance) and will only be granted at the discretion of the presiding judge.

Underpinning equity there are a number of 'equitable maxims' or guidelines upon which equitable remedies are granted and some of them include:

- equity acts on the conscience, as it tries to ensure that fairness is always done;
- equity is based on equality, as it attempts to adjudicate in a fair and equal manner between the parties in dispute;
- equity follows the law and will not depart from the common law unless the result would be unfair, unjust and unconscionable; and
- equity will not suffer a wrong without a remedy and even if the common law cannot assist, equity will step in to ensure that any person whose rights have been infringed will be assisted by the law.

Accordingly, in contract law, the law and principles of equity which are obtained from decisions of cases has also played a vital and significant role and function in contract law. One important concept is the equitable doctrine of promissory estoppel which allows a promise to be enforced and prevents a party from going back (resile) in their promises as well as the impact of unconscionable contracts wherein there is an unequal bargaining position and the courts will normally set aside these contracts on the basis that they are unfair and unjust. In respect to consumer protection various types of commercial agreements, such as employment contracts and consumer contracts, are now compelled to comply with consumer protection legislation to ensure that there is an equal balance in the transaction and entered into freely and willingly by both of the parties to the contract.

5.10 Statute Law or Legislation

Apart from the common law the other main source of law is statute law, that is enacted or laws created by parliament, which overrides the common law in the event of any clashes in the resolving of contractual disputes. The two main pieces of Legislation that are vital to the area of contract law is the *Statue of Frauds* 1677 (Imp) UK and any relevant *Fair Trading Acts, Sales Sale of Goods Acts* and *Consumer Protection Acts*. It should be mentioned that under the common law, the same legal principles apply to all types of valid contracts regardless of size and content.

However, the statute law has changed the effect and impact of the common law significantly, especially in respect to contracts that involve businesses that supply goods and services to consumers. In the event of a clash between the common law and the statute law where there is a dispute regarding the terms of a contract and or its validity, the statute law such as those mentioned above prevail. Essentially, statute law (legislation) has altered the principles of the common law in today's modern society in order to provide increased protection to consumers in the marketplace when buying goods and services from businesses and companies either in personal, via the internet or by mail. As contract law involves the rights and obligations of the parties who are privy to the contract (privity of contract), the law of contract often and in most cases always involves the application and an examination of both in the first instance common law (case law) and statute law which in most cases overrides the common law principles where the matter in dispute has been legislated on and the provisions of the particular statute will often apply in the final determination of the outcome of the contractual dispute.

5.11 Promissory Estoppel

The doctrine of promissory estoppel operates to enforce certain promises in contract that are not supported by any valuable consideration which is illustrated by a number of decided cases such as *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130; *Commonweatlh v Verwayen* (1990) 95 ALR 321; *Giumelli v Giumelli* (1999) 190 CLR 101; *Jorden v Money* (1854) 5 HL Cas 185; *Legione v Hateley (1983) 152 CLR 406* and *Walton Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387.

An action under promissory estoppel does not operate to enforce all gratuitous promises for which no consideration has been given. Essentially, promissory estoppel is an action in equity and in its modern form as a result of a number of case decisions it can be used by either party to commence a legal action. The enforcement of a non-contractual promise by the use of promissory estoppel as a 'sword' not a shield, on the basis that the promise relied on that promise and would suffer detriment or loss if that promise was not enforced was highlighted by this very important case. The courts will only enforce promises made between the promisor and the promisee if any of the following important elements supporting an action under promissory estoppel are present.

The important elements in respect to the operation of the doctrine of promissory estoppel includes that:

- there was a clear and definite promise made between the promisor and the promise;
- the promise gave rise to a certain understanding in the mind of the promisee;
- the promisee relied on the actual promise by undertaking to do something or refrain from doing something;
- the promisee would incur damage or detriment if the promisor is allowed to go back on their word and from the promise; and
- the promisor acted in an unfair manner and unconscionably.

5.12 Statute of Frauds

In respect to contract law, the statute of frauds applies in some instances requiring the specific types of contracts to be evidenced in writing. Even if the contracts entered into are not evidenced in writing it does not mean that the validity of the contract is effected in any way, but instead the contract may be unenforceable in a court of law.

This requirement that some proof, such as a note or memorandum, must be provided as evidence of the contract is contained in the *Statute of Frauds* 1677 (Imp) UK. In respect to contracts for the sale of goods to the specified value of $20 (£10) (€40) or more, s 4 (1) of the *Statute of Frauds* provides that the contract shall not be enforceable unless it is evidenced in writing by either a note or memorandum. Even though the $20 (£10) (€40) was the figure adopted in 1677, it is still relevant today and it is still a requirement in business that very small contracts for the sale of goods are to be evidenced in writing or at least evidenced by a note or memorandum in order for it to be enforceable.

5.13 Consumer Protection and Fair Trading Legislation

The impact of statute or legislation on contract law is evidenced by the many consumer and fair trading legislation that exists within legal systems whether common law or civil (code) law as well as international conventions such as the *Vienna Sales Convention* (*Convention for International Sale of Goods*) whose primary aim is consumer protection. In respect to the consumer protection provisions contained within consumer protection legislation the most important sections are the general and specific provisions dealing conduct by a corporation in trade or commerce that is misleading, deceptive or likely to mislead or deceive.

Generally these statutes which are also reinforced by trade and sales conventions in the international domain, such as the *Vienna Sales Convention*, are very powerful and they often extend to the prohibition to individuals as well in some circumstances if they are operating a business internationally as well as locally or nationally. The consumer protection provisions target the conduct and do not merely apply to contractual situations. This means that if the conduct deemed to be misleading or deceptive it is irrelevant if there is a contract or not and the mere fact that the conduct has occurred is in breach of the misleading or deceptive provisions.

Generally consumer protection legislation also provide additional assistance to the parties that are involved in a contract and especially in situations where one of the parties to the contract is a consumer. Thus, the consumer protection legislation enhance and supplement the common law and equity to ensure fairness and justice and to eliminate oppressive and unconscionable behaviour in the marketplace for the aim of consumer protection. Each country conducting business also have fair trading and legislation which together with general sales of goods and consumer legislation operate to regulate contracts for sale of goods. The *Fair Trading Acts* generally apply to the areas and entities that are not regulated by federal or supreme government and apply to unincorporated business organisations such as sole traders and partnerships and generally are considered after the other consumer protection provisions of the state in any dispute involving contracts for sale of goods.

Key Points

The key points in this module are:

MO1: **Defining a Contract:** An (valid) agreement or promise made verbally (oral) or expressed (written) between two or more parties that the law sees as being legally enforceable.

MO2: **Identify the elements of a simple contract:** The elements of a simple contract agreement, intention, consideration, genuine consent, capacity, legality and form.

MO3: **Distinguishing between an agreement and a contract:** An agreement is does not always lead to a contract, such as domestic or social agreements that are not intended to be legally enforceable in a court of law. However, a contract is legally enforceable and is defined as agreement containing promises that were made between two or more parties with the intention of creating certain legal rights and obligations and enforceable in a court of law.

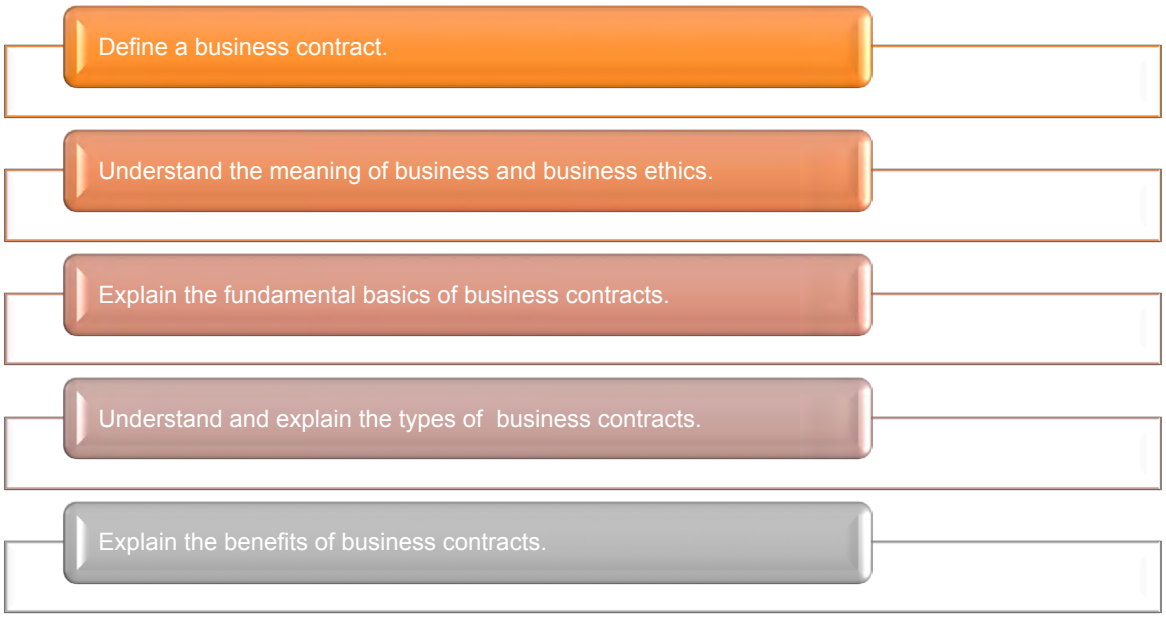
MO4: **Outlining the elements to be satisfied in order to make a simple contract valid:** The elements to make a contract valid instead of an apparent simple contract are agreement, intention, consideration, genuine consent, capacity, legality and form.

MO5: **Distinguishing between a formal and a simple contract:** A formal contract is a contract that must be written in a special way, that is, form and as a result it does not need any consideration as it gets it validity from its form alone and is generally called a contract under seal, deed or contract of record. However a simple contract is not a contract under seal or a contract of record and for its validity and enforceability it must have valuable consideration.

Module 6 Contract Law in Business

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Business Contract: An agreement that gives rise in a business context to legal rights and obligations.

Commercial or Business Law: Commercial law is sometimes referred to as Business Law is the body of law which governs business and commercial transactions.

Franchise: Is a contractual relationship between the franchisor and the franchisee in which the franchisor agrees to maintain a continuing interest in the business of the franchisee.

Joint Venture: A type of business agreement that is similar in characteristics to a Partnership, but is distinguished from a partnership on the basis that it is formed for a particular task and only for a specified time and is not a continuous agreement and there is not an ongoing relationship between the parties.

Contract law in business

Contract law is very important in all aspects of doing business and negotiating business at a local, national and international level. It is based on the classical contract theory that is based on the idea that the parties to a contract are free to contract on whatever terms they wish as long as they both agreed. Accordingly, a business contract that is negotiated between parties usually states the terms and conditions of the business transaction, including product sales and delivery of services. It is preferable that contracts entered into between parties when entering into business is expressed (written down) as this assists the parties involved to avoid any type of misunderstanding that may arise in the absence of a written contract.

Even when negotiating a business deal or transaction with a friend or family member it is considered to be more important to reduce the contract in writing so that all the terms and conditions negotiated are clear and not misunderstood. By putting the contract in writing it will usually assist in avoid any misunderstandings in the future in the event of a contractual dispute. If parties that enter into a contract, merely rely on an oral agreement, then they may forget some important and crucial points that were discussed and agreed to verbally at the time of negotiating the terms and conditions of the contract. But with a written agreement, all the terms and conditions are expressed and clear at any point in time and the written agreement can always be amended with the consent of both of the parties.

6.1 Basics of Business Contracts

There are many types of commercial or business contracts negotiated every day such as contracts for sales of goods and insurance contracts. Business contracts are an important part of conducting business and even more important if the business also operates online. Without a business (commercial) contract that addresses expectations, procedures, and policies, many business entities may be involved in a contractual business dispute in dealings with customers, suppliers and distributors. The business contract keeps the work legitimate and protects both parties.

Under a contract it is essential that both parties agree to the terms outlined in the negotiated contract and acknowledge their agreement with an authentic signature. For every transaction that requires the party or parties to conduct a different task for their client or customers the business is required to provide a written business contract which can take many forms from a purchase order to an offer and acceptance when buying real estate. Some clients and customers in the market place when dealing with businesses, may not like this idea, but irrespective of this, this procedure is vital and essential and a measure of protection to all business and it also ensures that both parties keep to their end of the agreement as specified and agreed to in the terms of the contract that was signed by the parties at the beginning of the contract.

At one time, a handshake or someone's word was all a business deal, transaction or proposition was required. Today, however, in a globalised world transactions both conducted in the traditional form and via the Internet, are a lot more complex. As a result of this complexity, it is beneficial and prudent for businesses to enter into business agreements in writing regarding all aspects of the types of business being negotiated and transacted between the parties. A business contract also provides a sense of security to both parties to knowing they are on "common ground" in regards to the business relationship. A well thought out contract helps alleviate potential problems by addressing them before they actually take form and avoids the potential for a contracted dispute and expensive litigation.

6.2 Common Types of Business Contracts

Contract negotiations are vital when entering into a contact in order to ensure that all parties are aware of the stipulated terms of the contract and their rights and obligations under the contract that is formed. There a many types of business or commercial contracts that are negotiated and some are created to suit the actual situation or proposed transaction and as well as on an "as needed basis", for instance:

- Work-for-hire: companies create a work-for-hire contract when they are hiring an outside contractor to perform certain tasks. The contractor works independently and is responsible for claiming the money he or she makes to the taxation office.
- Confidentiality or non-disclosure: This contract protects the company's personal and confidential material. If the company is sharing valuable client information or trade secrets, it is important that this contract be in place. By agreeing to this type of a contract, the independent contractor is agreeing to not disclose business information or use trade secrets for personal gain.

- Non-compete or restraint of trade contracts: This type of a contract stops the independent contractor from competing with your business or stealing your ideas. Anyone that he or she comes in contact with must be addressed as your client, not theirs.
- Service agreement: A service agreement is common among online business services. The contract ensures that both parties receive what they expect. The client receives the work he or she has hired you for, and you receive payment for your services. This agreement should always be signed by both parties. See Table 6.2 Types of Contracts entered into by Business Entities.

It is preferable to have a written business or commercial contract between the parties as in the event of something unforeseen, a business contract is clear and express evidence of what was negotiated between the parties.

6.3 Negotiations in Business Contracts

It's common practice for a business and its potential clients to often use a business contract that they have used to conduct business previously for consistency and understanding of the terms and conditions of the contract between the parties. Most people are open to negotiating the terms on their contracts, when entering into agreement, and if one of the parties to the negotiation is hostile or difficult to deal with, then as a matter of course that contract will inevitably end up in dispute over the terms and contains of the contract between the parties.

In respect to negotiations in contract law an offer will not arise merely because parties have reached agreement on one aspect of the deal. Other aspects of the negotiation have to be finalised, such as any implied (or express) understanding that the parties are not bound until a formal contract is executed as well as the adoption of any specific heads of agreement that essentially provide for and include the negotiated terms and conditions agreed to by the parties.

6.4 Benefits of Business Contracts

It is beneficial and preferable to have a written business or commercial contract as a means of protecting the assets of the business as well as its reputation with effective documentation which will assist in any contractual disputes that may arise. The contract style and format applied by a business may change over the years, but the main basis or purpose of it always remains the same that is asset protection and customer satisfaction.

6.5 Contracts and Business Arrangements

Contracts do not always have to be in writing in order for them to be legally binding, valid and enforceable in a court of law as there are a number of specific exceptions. However, in the application of contracts to business or commerce, signed written contracts are usually the most desirable form of contract, especially when it comes to business or commercial arrangements. This is because unlike oral or verbal contracts, in all written contracts, the contents ('terms') are in writing for all to see; they can ensure that precise language is used in describing the terms of the agreement; there is, therefore, less opportunity for misunderstandings and conflicting assumptions; there is less need to rely on memories of what was originally agreed; and the individuals involved in the transaction may change over time.

Verbal agreements may be difficult to prove, difficult to remember precisely, and open to misunderstanding. In resolving a dispute on this issue, the conduct and statements made by each party leading up to the contract under challenge will be the critical issue. Contracts can be a mixture of written and verbal agreements when the written agreement does not contain many terms. If a written contract does not appear to be complete, verbal undertakings and conduct will be considered.

It is a rule of law that when a contract has been put in writing, and it appears to be complete, it will be accepted against a contradictory verbal agreement. In business arrangements, it is usually preferable to have a full written contract in order to avoid all the pitfalls of, proving a contract existed; proving it to be a complete or incomplete document; proving verbal undertakings; and interpreting people's conduct. In this regard, contract law recognises a number of different types of legally binding and enforceable contracts as illustrated by Table 6.1 Types of Contracts.

Written	Verbal	Mixture
Formally agreed	Verbal agreements are generally just as binding as written agreements	Quite often contracts are a mixture of verbal and written agreements

Table 6.1 Types of Contracts

6.6 Written Contracts in Business

In respect to written contracts in business as illustrated by Table 6.2 Types of Contracts entered into by Business Entities, when applied to business or commercial contracts:

- If the contract has been formally written and signed by the parties, there is an assumption that all the terms of the agreement are contained in the written document regardless of what may have been verbally agreed.
- Contracts can be a combination of written and verbal agreements when the written agreement itself covers very few terms.
- When a contract is signed, it is assumed that all the terms have been read and agreed to.
  - If unsigned, a written contract must be presented to and understood by all parties to be valid; and be recognised by all parties as a contract, that is, it must look like a contract and not simply a receipt or docket.

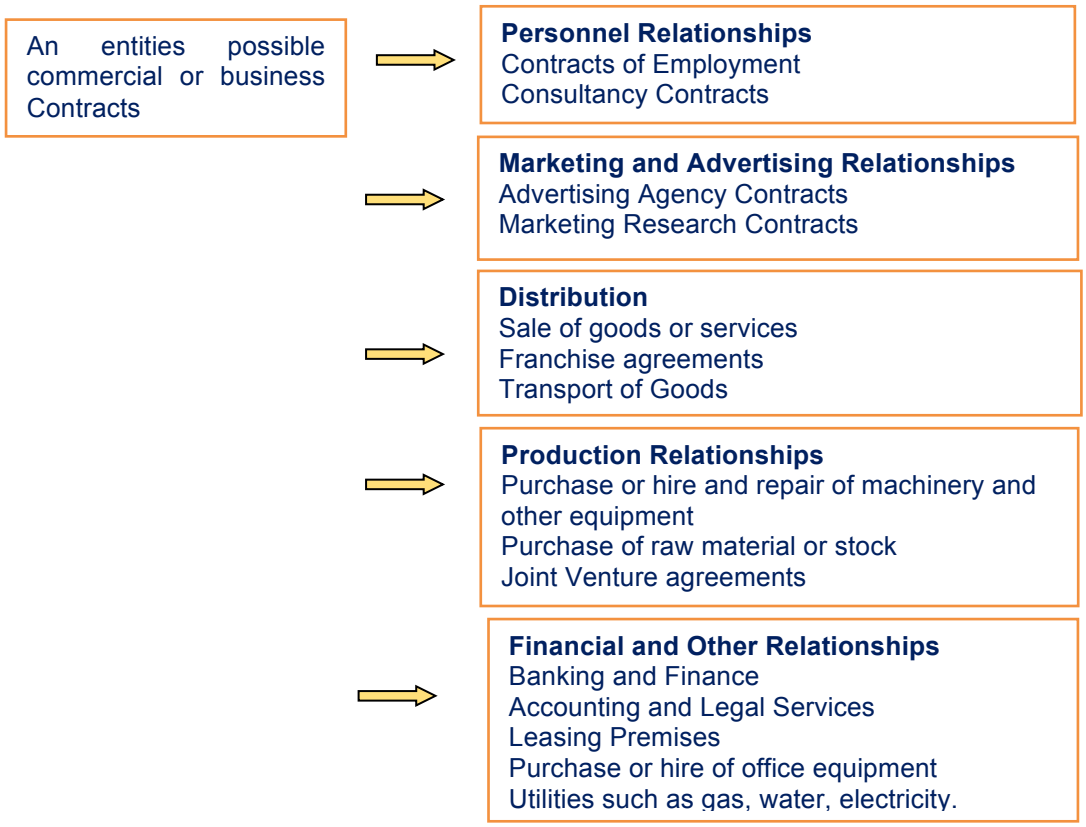


Table 6.2 Types of Contracts entered into by Business Entities.

6.7 Contracts and Verbal Agreements

Verbal agreements rely on the good faith of all the parties and can be difficult to prove. However, in some situations, insisting on a detailed written agreement may be counter-productive if:

- the value of the transaction is not particularly high; and/or
- the presentation of a substantial document, possibly with many provisions, may raise more questions and uncertainty in the minds of the parties than it resolves, ending in the transaction not proceeding. If you are confident of the good faith of the party, a less intimidating form of written arrangement may be the best course of action.

In respect to verbal (oral) agreements even if it is not in writing it does not mean that it can never be proved. Verbal agreements can be supported by:

- the conduct of the other party both before and after the agreement
- specific actions of the other party
- past dealings with the other party

6.8 Common Business Contracts

There are many types of business or commercial contracts that are negotiated each day. Some of the more common types of business contracts in business or commerce include the following:

Sales-Related Contracts:

- Bills of Sale
- Agreement for the Sale of Goods
- Purchase and Delivery Orders
- Warranty and Limited Warranty
- Security Agreement

Employment-Related Contracts:

- Employment and Independent Contractor Agreement
- Consulting and Distributor Agreement
- Non-Compete or Restraint of Trade Agreements
- Sales Representative and Service Agreement
- Confidentiality Agreement
- Reciprocal Nondisclosure Agreement
- Employment Separation Agreement

Leases:

- Real Property Lease
- Equipment Lease
- Business Equipment leases

General Business Contracts:

- Franchise Agreement
- Advertising Agency Agreement
- Indemnity Agreement, Guarantee and Indemnity
- Covenant Not to Sue
- Settlement Agreement
- Release and Assignment of Contract
- Stock Purchase Agreement
- Partnership Agreement
- Joint Venture Agreement
- Agreement to Sell Business
- E-commerce Terms and conditions

Some of the more common types of business contracts used by business entities that are discussed more fully include bills of sale, delivery orders and franchises.

6.8.1 Bills of Sale

A bill of sale is a legal document made by a 'seller' to a *purchaser*, reporting that on a specific date, at a specific locality, and for a particular sum of money or other "value received", the seller sold to the purchaser a specific item of personal, or parcel of real, property of which he had lawful possession. It is a written instrument which evidences the transfer of title to personal property from the vendor, seller, to the vendee, buyer.

6.8.2 Delivery Orders

A delivery order is a document from a consignee, a shipper, or an owner of freight which orders the release of the transportation of cargo to another party. Usually the written order permits the direct delivery of goods to a warehouseman, carrier or other person who in the course of their ordinary business issues warehouse receipts or bills of lading. A delivery order which is used for the import of cargo should not to be confused with delivery instructions. Delivery instructions provides "specific information to the inland carrier concerning the arrangement made by the forwarder to deliver the merchandise to the particular pier or steamship line.

6.8.3 Franchise Agreement

A franchise is a contractual relationship between the franchisor and the franchisee in which the franchisor agrees to maintain a continuing interest in the business of the franchisee in such areas as technical knowledge; advertising and marketing; product control; and expertise and training.

Under this type of agreement the franchisee agrees to operate the business under a common trade name, format and procedure that is actually owned and controlled by the franchisor. Even though under this franchise agreement, the franchisee is self-employed but the franchisor still retains considerable control over the franchised business to ensure it trades successfully within the franchise system of operation.

There are a number of benefits for operating a business under a franchise agreement especially for persons who have little or no business experience and who wish to enter business which include the following:

- Virtually instant reputation and goodwill;
- Marketing;
- Financial expertise;
- Training and ongoing support;
- Proven operational system;
- Economies of scale;
- Expertise in site selection and shop fitting out; and
- Business risk is reduced.

There are a number of different types of franchise operations such as manufacturing, product, system of operation and group trading. Some well-known examples of franchise operations includes McDonalds, Kentucky Fried Chicken and Pizza Hut.

6.9 Joint Venture Agreements

A joint venture agreement is similar in characteristics to a Partnership. However, it is distinguished from a partnership on the basis that it is formed for a particular task and only for a specified time and is not a continuous agreement. Also there is not an ongoing relationship between the parties as there is in a partnership agreement. The joint venture agreement is negotiated between different parties and is formed to undertake and pursue a commercial or business activity for joint profit. This type of business or commercial agreement is used in such areas as mining, property development, manufacturing, publishing, entertainment and share farming. A joint venture is distinguished from a partnership in a number of distinct ways, and one of them is that it is usually entered into for a one off or *ad hoc* undertaking for a specific task and time, and once completed the joint venture agreement is ended and terminated.

6.10 Contract Law in Business

Commercial law which is sometimes referred to as business law is the body of law which governs business and commercial transactions. Commercial or business law is often considered to be a branch of civil law and deals both with issues of private law and public law. There are a number of contract formalities in respect to the entering into, negotiation and enforceability of such contracts to enable business to be transacted between individuals and individuals or between individuals and business or corporate entities.

Commercial or business law includes various types of entities and enterprises within its scope such as the relationship of principal and agent, contracts for carriage by land and sea, contracts for merchant shipping, contracts of guarantee, life, fire, marine and accident insurance, bills of exchange and partnership. Commercial or business law can also be applied to the regulation of corporate contracts, hiring practices, and the manufacture and sales of consumer goods and whose common law basis has been embodied in consumer protection legislation.

A contract is an exchange of promises between two or more parties to do, or refrain from doing, an act which is enforceable in a court of law. A contract is a binding legal agreement, that is to say, *"a contract is an exchange of promises for the breach of which the law will provide a remedy"*. A contract is "an agreement creating and defining the obligations between two or more parties". Agreement is said to be reached when an offer capable of immediate acceptance is met with a "mirror image" acceptance (an unqualified acceptance). The parties must have the necessary capacity to contract and the contract must not be impossible or illegal. Contract law is based on the legal principle that "agreements between the parties must be kept". A breach is recognised by the law and remedies can be provided.

Sometimes in cases where the transactions are of a serious financial nature, written contracts are required, such as when buying a house or a car. However, most contracts can be and are made orally, such as purchasing a book or a sandwich. Contract law can be classified, as is habitual in civil law systems, as part of a general law of obligations, along with tort, unjust enrichment or restitution. The key elements and requirements for the creation of a contract in commerce or business are: offer and acceptance (agreement); consideration; an intention to create legal relations; legal capacity and formalities of the contract.

6.11 Formalities of Business Contracts

In business or commerce a mutual exchange of promises that are merely spoken can still be binding, valid and legally enforceable as an expressed (written contract). A contract that is spoken is called an oral or verbal contract. Any contract that uses words, spoken or written, is a verbal contract. Thus, all oral contracts and written contracts are verbal contracts. This type of contract is in contrast to a "non-verbal, non-oral contract," also known as "a contract implied by the acts of the parties", which can be either implied by fact or implied by law. Most jurisdictions have rules of law or legal principles and Statutes which may render otherwise valid oral contracts unenforceable.

This is especially true in respect to oral contracts that involve large amounts of money or real estate where the Statute of Frauds is operative in order to prevent false allegations of the existence of contracts that were never made, by requiring formal (written) evidence of the contract. Generally, contracts that do not meet the requirements of common law or statutory Statutes of Frauds are unenforceable and rendered void. In situations, where a party to a contract has acted in an unconscionable or unjust manner, the party who unjustly enriched himself or herself by an unenforceable contract may be required to provide restitution for unjust enrichment.

The *Statutes of Frauds* are typically codified in state statutes covering specific types of contracts, such as contracts for the sale of real estate. Generally, for contracts that are subject to legislation equivalent to the *Statute of Frauds* or equivalent, there is no requirement for the entire contract to be in writing. However, under the *Property Law Acts* for real estate transactions there must be a note or memorandum evidencing the contract, which may come into existence after the contract has been formed. The note or memorandum must be signed, and a series of documents may be used in place of a single note or memorandum. It must contain all material terms of the contract, the subject matter and the parties to the contract.

If a contract is in a written form, and signed, then the person is bound by its terms regardless of whether they have read it or not, provided the document is contractual in nature. If a party wishes to use a document as the basis of a contract, reasonable notice of its terms must be given to the other party prior to their entry into the contract, including such things as tickets issued at parking stations, business orders, spoken orders or commercial orders, bills of exchange, joint venture agreements, lease contacts, insurance contracts and franchise contracts among others.

6.12 Business Orders

In business or commerce, an order is a stated intention, either spoken or written, to engage in a commercial transaction for specific products or services. From a buyer's point of view it expresses the intention to buy and is called a purchase order. From a seller's point of view it expresses the intention to sell and is referred to as a sales order. When the purchase order of the buyer and the sales order of the seller agree, the orders become a contract between the buyer and seller. Within an organisation, the term order may be used to refer to a work order for manufacturing, a preventive maintenance order, or an order to make repairs to a facility. In many businesses orders are used to collect and report costs and revenues according to well defined purposes. Then it is possible to show for what purposes costs have been incurred.

6.13 Spoken Orders

Businesses such as retail stores, restaurants and petrol stations conduct business with their customers by accepting orders that are spoken or implied by the buyer's actions. Taking a shopping cart of merchandise to a check-out counter is an implied intent to buy the merchandise. Placing a take-away order or dining-in order at a restaurant is a spoken purchase order. Putting petrol into one's tank at a petrol station is an implied order. The seller usually expects immediate payment by cash, cheque or credit card for these purchases, and the seller provides the buyer with a receipt for the payment. In legal terms, this form of business order is an "implied in fact contract".

6.14 Commercial Orders

In business or commerce, various business documents are used to record the negotiation of an agreement to buy and sell, record the agreement itself, and record compliance with the agreement and closure of the contract. An agreement to buy and sell is a form of contract. There are five basic requirements for a contract to exist between two parties: agreement, voluntary, consideration, capacity, and legality. A sixth requirement of "in writing" sometimes applies.

The main concern for commercial orders is that there must be agreement (offer and acceptance) for the order to be a contract. Prior to this, businesses often record the details of negotiations by using a request for quotation, request for bid, sales quotation, or sales bid. Quotations are non-binding and part of the negotiation process. A request for bid can be binding or non-binding, depending on the terms of the bid. Once an agreement or contract is in place, businesses record these agreements or contracts as confirmed purchase orders and sales.

6.15 Online Contracts (e-Commerce)

An online contract is easily made, and on a lower scale it's usually for a period of one month to three months and on bigger scale it's normally about five years. As with all things legal in general with regard to the ever-evolving law of the internet in particular, general rules are often riddled with exceptions. All cases are truly evaluated on their own merits, which merits are defined by the facts presented in each instance. Thus, it is the visionary site owner that does what it can do to enhance the odds in its favour even though there can be no guarantees of any enforceability. E-signature law made the electronic contract and signature as legally valid as paper contracts so this is the reason 90% of people enter into online contracts before reading the content and it has been observed that within one second around one hundred and ten contracts are being signed. With all of the components of valid contract, it makes online contracts legal and binding between the buyer and the online seller.

Key Points

The key points in this module are:

MO1: **Defining a Business Contract:** Business Contract: An agreement that gives rise in a business context to legal rights and obligations. Commercial or Business Law: Commercial law is sometimes referred to as Business Law is the body of law which governs business and commercial transactions.

MO2: **Meaning of Business and Business Entities**: A business is established in order to make a profit and normally consists of two or more persons in partnership or a company. Business entities is the word used to denote the type of business structure that is in operation such as a Partnership, Company, Franchise, Joint Venture or a Trust.

MO3: **Basics of Business Contracts:** The basics of business contracts include operating with a view to making a profit. Contract Law is very important in all aspects of doing business and negotiating business at a local, national and international level. It is based on the classical contract theory that is based on the idea that the parties to a contract are free to contract on whatever terms they wish as long as they both agreed and also keeps the work legitimate and protects both parties.

MO4: **Types of Business Contracts:** There are many types of business or commercial contracts that are negotiated each day. Some of the more common types of business contracts in business or commerce include sales-related contracts such as purchase orders, employment-related contracts such as a service agreement; leases and general business contracts such as a franchise agreement and a settlement agreement.

MO5: **Benefits of Business Contracts:** It is beneficial and preferable to have a written business or commercial contract as a means of protecting the assets of the business as well as its reputation with effective documentation which will assist in any contractual disputes that may arise. The contract style and format applied by a business may change over the years, but the main basis or purpose of it always remains the same that is asset protection and customer satisfaction.

Module 7 Basics of Contract Law

Module Objectives

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

Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Bargain: The relative ability of each party to achieve a better (or worse) outcome in a negotiation compared with the other and is a matter of practical relevance in a court action.

Misrepresentation: A false representation of fact, made expressly or impliedly, which induces a party to enter into a contact.

Negotiation: The process of communication with others to reach an agreement.

Parol Evidence Rule: Is the principle, that where a contract has been reduced to writing in a document that it is intended to be complete expression of the matters negotiated and agreed upon by parties.

Key Cases

Adams v Lindsell (1818) 106 ER 250.
Byrne and Co v Van Tienhoven (1880) 5 CPD 344
Carlill v Carbolic Smokeball Co [1893] 1 QB 256
Dickinson v Dodds (1876) 2 Ch D 463
Entores Ltd v Myles Far East Corp [1955] 2 QB 327
Felthouse v Bindley (1862) 11 CBNS 869
Fonq v Cilli 11 FLR 495
Goldsborough Mort & Co Ltd v Quinn (1910) 1 QB 674
Grainger and Sons v Gough [1896] AC 325
Masters v Cameron (1954) 91 CLR 353
R v Clarke (1927) 40 VLR 227
Routeledge v Grant (1828) 4 Bing 653

Basics of Contract Law

A contract is an agreement between two or more persons which will be enforced in a court of law. There are many components to contract law hence its complexity in terms content, rules, principles and cases in respect to various areas such as, basic fundamentals of contract law and application of contract law within business in a local, national and global dimension. This module will deal with some basic issues and rules in respect to the law of contract such as the rules relating to offer and acceptance. The important steps and elements of a contract such as intention to create legal relations and consideration will be dealt later modules respectively.

It should be mentioned in this context when discussing these very crucial steps or elements of a valid contract, that there are some important fundamental basics regarding the actual '*negotiation*' of a contract that needs to be addressed. Some of these basic but very important fundamentals in determining whether a contract exists and the manner in which it was 'constructed' whether expressed, orally or by implication include the standard of conduct that is expected between the parties, whether the contract requires to be in writing and the actual meaning of 'intention;' in contract law.

Accordingly, in ascertaining whether a contract does in fact exist, the law of contract has traditionally required the plaintiff to prove and establish the existence of the various steps or elements that essentially give rise to a valid and enforceable contract, such as an offer with a corresponding acceptance and consideration which give rise to an 'apparent' simple contract. For its validity the other four essential steps or elements such as genuine consent, capacity of the parties, legality of object and form must also be satisfied in order for the contract to be enforced in a court of law.

7.1 Defining a Valid Contract

A valid contract is an agreement that contains the promises (bargain) that are made between two or more parties who has the intention to create legal relations and obligations that are legally enforceable in a court of law with one another. Contract law depends on seven essential elements or steps in order for it to be valid and legally binding between the parties and in respect of these steps or elements a number of different questions are raised by the courts. These seven essential elements or steps and the questions that are normally asked or determined by a court of law is illustrated by Table 7.1 Elements of a Valid Contract.

Step or Element of Contract Law	Question Raised by the Court
Intention to create legal relations	Did the parties have an intention that is a plan to enter into a legally binding and enforceable contract?
Agreement – Offer and a corresponding Acceptance	Who made the Offer? Who made the acceptance, that is, who gave their approval? Were the offer and acceptance valid? Was there genuine consent and agreement that is a 'meeting of the minds'?
Consideration	Did the parties exchange something of value to support the promises made or exchanged in the bargain?
Contractual capacity	Did the person making the offer that is the Offeror have the legal capacity that is, the ability and understanding to enter into a valid contract.
Genuine Consent – Terms of the contract	Did the parties give real and genuine consent? Were the parties free to make up their own minds as to whether they wished to enter into the contract or were they coerced or induced?
Legality of Object	Was the main purpose or the article of the contract legally acceptable or was it illegal or contrary to public policy?
Form	What was the nature or form of the contract? Was it simple or formal? Are there any statutory requirements that need to be satisfied for its validity?

Table 7.1 Elements of a Valid Contract.

As such depending on the types and nature of the promise contracts can take various forms and may arise from simple oral agreements or more complex and formal written agreements which gives rise to the classification of contracts as formal contracts and simple contracts. Essentially a valid contract is an agreement that is made between two or more parties, which may include companies and other types of business organisations, that give rise to various rights and obligations that are enforceable in a court of law. Each day people enter into many different types of contracts, but only a few of them will be classified as contracts and actually be valid and legally enforceable. The law of contract's main purpose and function is to determine the circumstances in which people are legally bound by the promises that they have made. Therefore, to enable a person to determine when a person is bound by a promise that has been made, it is necessary that all the essential elements of a valid contract are present.

A contract is simply defined as 'a legally binding agreement between two or more parties'. Thus, a contract is said to be formed when there is a '*meeting of the minds of the parties*' (intention), the agreement between the contracting parties who have entered into the valid contract voluntarily. Contracts then begin a mere agreements but it is the element of the agreement being *legally binding* and the actual Intention of the parties that elevates the agreement into a valid and enforceable contract between the parties who agreed to be bound.

For a contract to be legally enforceable in a court of law there are a number of elements of a valid contract which must satisfied before a valid and binding contract is deemed to exist and which elevates the agreement to a valid and enforceable contract. This requirement of agreement suggests that there is a mutual intention to be legally bound by each of the contracting parties, which changes the agreement into a valid contract. However, not every agreement will give rise to a valid contract and only those agreements that are entered into with the intention to be legally binding and enforceable in a court of law will give rise to a contract between the parties who must perform their duties and obligations us agreed otherwise they can be sued for damages for breach of contract.

If the parties did not actually intend that their agreement was to be legally binding then they may still have a mutual agreement between them, but the only difference is that it will not be enforced in a court of law if a dispute arises in respect to the agreement. The courts wherever possible attempt to give effect to the intentions of the parties by applying an objective test that is based on what a reasonable person would conclude from the given facts and circumstances. In any contractual dispute the courts in resolving the dispute will look at the words and actual conduct of the parties and the length of time that the contract had been in place to determine whether there was real intention to be bound by their agreement.

7.2 Meaning of Intention

Contract law is mainly concerned with determining the *intention* of the parties or of one of the parties at the time when the contract is being negotiated. Intention in this context has two distinct meanings:

- To determine subjective intention, which is concerned with an examination of a person's state of mind; and
- To determine objective intention which is to ignore the person's state of mind and to look solely at what that person actually said and conducted himself or herself did at the time that the contract was being negotiated.

In respect to what one of the parties said and conducted himself or herself, during the negotiation of the contract it is possible to conclude that any reasonable person that said did the same things, within the same context, must have had a particular intention, that is the intention to enter into the contract and be bound, and this is called the reasonable person test. The courts are generally only concerned with objective intention which means that the courts are only concerned with establishing what the parties' have meant instead of what each of them actually meant. This means that the intentions of the parties are judged by their actual actions and words instead of by their thoughts.

7.3 Conduct and Negotiation

In the negotiation of a valid and legally enforceable there is a standard of conduct that is expected between the parties when negotiating a contract. When parties negotiate a contract it does not merely consist of the application of the rules of offer and acceptance, which create the *agreement* to be legally bound. This means that when a contract is being discussed and negotiated, it has to be negotiated in such a manner that adheres to certain expected standard of conduct by the parties during the negotiation phase of the contract. Even though parties are at liberty to negotiate the best terms on which the contract is based in order to gain a financial benefit and or the best deal within the purported contract, the parties must not engage in conduct that is unfair, unjust or inequitable. For example, parties that are negotiating a contract should not engage in conduct that is misleading, unconscionable or unfair thus giving rise to an application of vitiating factors.

7.4 Legality of Contract

There is no formal requirement for contracts to be in writing apart from a few exceptions, such as contracts for the sale of land and contracts of guarantee. It should be noted that an oral agreement (not expressed or reduced in writing) is enforceable in the same manner as a written (expressed) agreement. In order for a contract to be legal it does not have to be in writing and not all contracts that are entered into on a regular daily basis need to be expressed (written down) in order for them to be legally effective. Accordingly, many contracts both large and small are negotiated and entered into without them being reduced to writing (expressed).

However statutes specifically require that the contract that is being negotiated must be reduced to or evidenced in writing for it to be legally valid and enforceable while some will be rendered void (no legal effect) if they are not in writing. In respect to the need for contracts to be in writing to be legal, there are three main categories:

- contracts that must be fully written down, otherwise they may be rendered void, such as:
    - all formal Deeds, such as deeds of settlement, wills and mortgage deeds;
    - cheques, promissory notes and bills of exchange;
    - transfer of shares (personal property); and
    - assignment (transfer) of copyright.

- contracts that should be evidenced in writing, otherwise they may not be enforced by courts of law, such as:
    - the sale and purchase of land (real property);
    - a personal guarantee;
    - emails, as electronic means pf communication is accepted as evidence; and

- all other remaining contracts which do not need writing.

Even though the law does not always require that contracts have to be reduced or evidenced in writing, very often contracts are written down or there is documentary evidence of the agreement in written form to suggest and support a contract such as an invoice, cheque or receipt. Where the agreement has only been negotiated orally, the contract that has been negotiated and created by the parties is described as parol or oral and in respect to written contract the parol evidence rule applies.

Accordingly, a contract that is not expressed (written down) but made verbally or orally is still considered to be a valid and legally binding agreement. It is preferable for a negotiated contract to be evidenced in writing as the event of a dispute regarding the terms or other issue surrounding the negotiated contract, it is easier to prove physical written evidence instead of just relying on what the parties remember regarding their conversations during the negotiation phase of the contract.

7.5 Parol Evidence Rule

After parties have negotiated a contract and have finalised it by expressing or evidencing the contract in writing, they often make verbal (oral) statements or promises after it has been concluded. These oral (verbal) statements or promises in this instance are not legally enforceable because the *parol evidence rule* may apply. Where a contract that has been negotiated has been expressed (written) down, the courts hold the view and presume that the actual written document actually contains all of the terms and everything else that the parties had negotiated and agreed upon before entering into the contract.

Accordingly, this rule means that all the exact terms and all statements and promises that were made between the parties are all contained in the written (expressed) contact within the "four corners" of the document comprising the contract and there is no requirement to look beyond the written contract itself for its validity and enforceability. Generally, oral (verbal) statements and other evidence are not permitted to be used by either party in order to attempt to vary, contradict or challenge the original written contract.

The main reason for this principle is commercial viability and to preserve "finality in written instruments" and to prevent unnecessary alteration of words which may make the contract unconscionable, ambiguous or absurd in its final meaning. However, the Law recognises that sometimes mistakes are made between the parties when negotiating a contract and have allowed certain exceptions to the *parol evidence* rule in order to alleviate any unfairness in its application and hence have permitted the following exceptions in relation to partial records and rectification; collateral contracts; custom and usage; condition precedent and ambiguity.

7.6 Executing the Agreement

After a contract has been effectively negotiated and entered into, both parties are usually bound by the terms that are contained in the written agreement that they *agreed* to *sign.* The law presumes that there has been actual agreement and genuine consent by a party to all of the terms and conditions that have been agreed to and expressed, that is, written, down in the contract because of the fact that the party signed the contract and their signature is on it. This is because under the common law and statute law certain exceptions apply and can be raised in some limited situations in order to not be held and be bound by the terms of the contract that they signed.

Accordingly, under the common law and reflected in statute law, the accepted and permitted exceptions include the vitiating factors of misrepresentation; *non est factum*; and unconscionable conduct in contracts. These exceptions are important as they provide an avenue for a party signing the contract to be exempted and not be bound by the contract. Some of these exceptions include misrepresentation and unconscionable conduct and are referred to as '*vitiating (faulty or defective) factors*' and they will be covered more fully in a later module.

7.7 Misrepresentation

At common law a signed agreement may not be legally binding upon the person who signed it as a result of an 'inducement' where there has been misrepresentation of the terms. In a general sense, a misrepresentation is a statement or conduct (representation) that is in fact false or misleading and gives rise to the misrepresentation. There are generally two types of representations: those that are not part of the contract and are referred to as simple representations, and no action lies in contract law; and those representations that form part of the actual contractual terms, and which are actionable under contract law.

A misrepresentation, which are false statements and which gives rise to different types of remedies depending on the nature of the misrepresentation are classified as:

- Fraudulent Misrepresentation – actual intention to deceive or cause harm was present;
- Negligent Misrepresentation – professional acting carelessly and recklessly and causing economic, financial or other harm; and
- Innocent Misrepresentation – there was no real intention to deceive or cause harm.

In respect to contract law, a misrepresentation is a *false statement of fact* that that has the actual intention of 'inducing' another party to enter into a contract. As a direct result of the inducement, and reliance on the facts, the party who signed as a consequence of the misrepresentation did so to their detriment and sustained injury or damage, such as economic or financial loss as a result of the misrepresentation. The remedy for misrepresentation is rescission of the contract. A misrepresentation can only be established if a discrepancy and inconsistency is evident between the true facts, whether past or present, and the misrepresented facts.

7.8 *Non est factum* (it is not my deed)

Under the law of contract *non est factum* (this is not my deed) is a plea (defence) by a person seeking to disown a deed or other legal document which it is alleged he or she sealed or signed, without being the true intention of the person signing and arises where there has been a mistake by one of the parties signing. This plea or remedy is available where a party has not acted carelessly or negligently by signing a document under a 'mistake' as to the actual *nature of the document*, the document may not be legally binding on the party making this plea on the basis that there is no real or genuine consent.

The basis of this plea (defence) allows the party who signed to avoid the legal effect of the document because it deems that as there was no real or genuine consent, the document has not really been signed because of a 'mistake' and that it was actually something different from what was actually believed to have taken place or intended by the party signing.

There are strict limitations to this defence and is only permitted in certain situations and where the successful party has proved that:

- The signing was done without undue carelessness or negligence;
- The document signed was substantially or radically different from what the party believed; and
- The mistake was concerning the fundamental nature of the document itself and not merely the contents.

There are only a few classes of persons who would be successful in alleging *non est factum* (it is not my deed: and include:

- Blind or visually impaired persons;
- Illiterate persons
- Persons suffering from a temporary disability; and
- Persons who are very ill that they have to rely on others to explain the nature of the document.

A successful plea of *non est factum* makes the document *void ab initio* (void from the beginning) and it does not create any legal rights or obligations. Where a genuine mistake has occurred there are various remedies available at common law, in equity and under statute law. If the mistake goes to the 'root' of the contract, that is, affects its very existence, then at common law the contract may be declared void from the beginning. Equity normally follows the common law and in some instances it may grant a remedy to prevent an injustice or hardship and these include rescission, specific performance and rectification.

7.9 Unconscionable Contracts

Unconscionable contracts refer to those contracts that normally involve contracts that are unfair, harsh or oppressive towards one party who is at a disadvantage and there is often an 'unequal' bargaining position. At common law the fact that a contract was negotiated in an unfair or harsh manner did not render the contract void or enabling it to be set aside by the aggrieved party. However, equity steps in to provide a remedy to a party where there is evidence to suggest that the contract was negotiated in an unfair, harsh, unconscionable and oppressive manner.

Any signed contract that is unconscionable or was negotiated and entered into with unconscionable or unfair conduct lacks, real and genuine consent and is not valid and will not be enforced by a common law court. Essentially these types of contracts and the terms of the agreement were entered into by one of the parties as a result of unethical, immoral and unjust or unfair conduct. The common law principle that binds a party to a written document has been altered by the courts as the result of the concept of *unconscionability* and the fact that where there was no real and genuine consent of the parties that signed then the contract may be set aside by the court.

7.10 Formal and Simple Contracts

Contracts are generally classified according to their actual *form*. Formal contracts are defined as such, because of the special way in which they are 'constructed' or 'formed' and usually there is a degree of formality when formal contracts are negotiated and actually entered into. For their enforcement in a court of law, formal contracts depend and require that certain specific formal requirements are satisfied. Formal contracts are essentially documents that are 'sealed and delivered' and are actually intended by the parties who signed the formal contract to take effect as a deed, that is, a contract under seal.

Such contracts normally have to comply with certain statutes for their legal effectives and form such as under the *Conveyancing Acts* in respect to the transfer of land (real property). In order to prevent or limit fraud, a formal contract, for it to be valid and legally enforceable in a court of law must be signed by both parties and their signatures have to be witnessed by independent third parties, and as distinct from simple, parol or informal or simple contracts, they do not require consideration.

Formal contracts obtain their legality and validity from their form alone as they are written in a special and formal manner and attested in a special and formal manner as required by legislation, including among others the *Statue of Frauds 1677* (Imp) UK and *Evidence Acts* for the main purpose of deterring and eliminating fraud in these types of contracts of a serious financial and business nature. There are two main types of formal contracts and they include:

- Deeds (contracts under seal) such as deeds of settlement, mortgage deeds and powers of attorney; and
- Contracts of record, such as court records.

A contract that is not a formal contract or that has to be written down in a special way, is referred to as a simple contract. Consideration is an essential element of a simple contract, which is not required in those formal contracts that are described as 'special', 'specialty', 'formal' or 'under seal'.

7.10.1 Formal Contracts

Formal contracts simply refers to agreements between two parties that are negotiated and made in writing and that must follow strict requirements in respect to form in order for these types of contracts to be valid and legally enforceable by either of the parties in a court of law in the event of a dispute.

Parties to the formal contract and who sign the deed generally do not have any valid and legal grounds for disputing the promises that they had made between them at the time of negotiation, unless they can establish ad prove that they did not give real and genuine consent.

Parties must take legal action within certain statutory time limits, and parties that are enforcing their rights under formal contracts as a result of the *Statute of Limitations* legislation generally have more time to take legal action than those have negotiated and entered into simple contracts. There are only a few contracts that are required by common law or statute to be in the form of a deed or under seal. The two main types of contracts that must be in written form and contained in a deed (contract under seal) include are:

- the appointment of an agent, such as a Universal Agents that are appointed under a Power of Attorney, in order to sign the deed on behalf of another person; and
- gratuitous promise which is a promise by one party to give money or property to another party who is not providing any consideration, that is something of value, and that can ever be legally enforceable if it is written down in a formal contract such as a deed.

7.10.2 Simple Contracts

All contracts apart from actual formal contracts (contracts under seal) are classified and referred to as simple Contracts. The fact that the contract is described as 'simple' is inaccurate as it gives the impression that they are just basic and uncomplicated, such as buying a bus or train ticket. However, simple contracts are also used to refer to and define large scale contracts such as the purchase of property and a multi-million-dollar business such as a petroleum distributorship, mining companies and retail businesses. Simple contracts are classified in a number of ways to distinguish the type and nature of remedy that is available to an injured party in the event of a breach of the terms of the contract.

Some simple contracts are *void,* which means that they have not legal effect whatsoever, unless the terms that were negotiated between the parties are actually written down (expressed) in the contract document. The main types of transactions that require the contract to be in writing as they constitute 'simple contracts' include, cheques, the transfer of rights in shares and copyright. There are some other types of simple contracts that are not legally enforceable unless they are actually evidenced in writing and the terms are expressed, written down, such as contracts involving guarantees to pay a debt and agreements made in consideration of marriage.

In respect to contracts entered into on the internet, and where written evidence is required of the simple contracts, the relevant conventions for *Electronic Transactions Acts* nowadays recognise as the legal equivalent of written documents, instantaneous forms of communications such as email documents for the facilitation of e-commerce. A simple contract once negotiated may take a number of 'forms' and can be either written, spoken or implied from past dealings with the parties concerned. If a simple contract is described as "expressed" it means that the contract was obviously created in writing, orally or a combination of both. Simple contracts can also be created by 'implication' or 'conduct' in respect to prior or past dealings between the parties. As contracts are not required to be reduced in writing or expressed unless they are of a specific kind type that the Law requires them to be in writing. As a result of the fact that contracts do not have to be in writing, when a dispute arises in respect to a contract, the court will decide the civil action on the balance of probabilities. This means that the court determines which of the parties is actually telling the truth and his or her version of the events is more believable. To prevent and reduce the risk of possible court action between the parties in the event of a contractual dispute, the parties should at all times write down an agree on the main terms of any proposed contract and the initial stages of the negotiation.

7.11 Statute of Limitations

Some states have all enacted legislation, which is known as the *Statutes of Limitation Acts*. These Acts require that the Plaintiff in a contractual dispute must commence a legal action within the maximum period that is allowed under the Statute in the particular jurisdiction. The time period in which the Plaintiff must commence the legal action is deemed to have commenced from the date of the alleged breach of the contract. However, in exceptional circumstances and if permitted by the Court, an action can commence beyond these periods of limitations, but in respect to a contractual dispute this does not happen very often due to commercial reasons and the huge financial and economic losses than can result from a long and protracted legal contractual dispute.

7.12 Elements of a Valid Contract

To form a valid contract, that is an agreement that is enforceable in a court of law, the arrangement that has been satisfactorily negotiated between the parties must show that certain elements (sometimes also referred to as requirements or key characteristics) that constitute the valid contract have been satisfied and are actually present. Accordingly, if any of these essential elements are 'missing' and not present, then the agreement, that is the offer with a corresponding acceptance, is not valid and legally enforceable, and the courts will not assist the parties to enforce the agreement in the absence of one of these essential elements or characteristics. The process of Agreement is illustrated by Figure 7.1 Agreements.

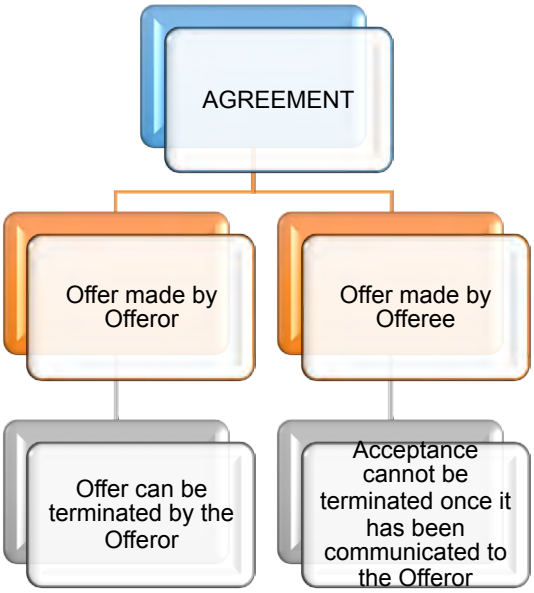


Figure 7.1 Agreements

There are seven essential elements that are required which form the basis of any contract. In order for a contract to be valid, binding and enforceable in a Court of Law the following essential elements must be present and satisfied and briefly they are:

- the Offer;
- the Acceptance;
- valuable and sufficient consideration (not required for formal contracts – under seal);
- free and willing intention to be bound and to create legal relations (meeting of the minds);
- genuine consent (mutuality, that is agreement must be mutual);
- legal capacity (certain parties, such as infants and bankrupts have limited or no contractual capacity);
- legality of purpose; and
- form (how it was constructed)

All of these essential elements must be present before a valid and binding contract can be created or formed and if any of these elements are missing then there is no valid contract. If any of the elements are missing then the contract may be unenforceable and may be set aside by the court returning both parties to their former position and relieving them of any obligations and rights under the contract.

7.12.1 The Offer

As soon as it has been established that the parties intended to create legal relations, it is necessary to determine whether an agreement has actually been reached or entered into between the parties. For the purposes of contract law there must be an actual 'meeting of the minds' between the two parties in the agreement. This means that there is actual 'consensus' agreement between the two parties in that they have the same thing in mind. An offer is the first or initial stages of an agreement and it is an expression that shows the willingness of the offeror (person making the offer) to enter into pre-contractual negotiations with the offeree (person to whom the offer is made).

In some situations it can be very difficult to determine whether in fact an actual offer has been made and satisfactory accepted by applying with all of the terms and conditions of the offer. In these circumstances the courts apply the objective test of the 'reasonable person' to determine whether in fact a reasonable person in the position of the offeree would believe that an offer had actually been made and that a binding and enforceable agreement would follow upon its acceptance. The leading case in respect to the offer and whether there has been a genuine, free and willing acceptance is illustrated by the case of *Carlill v Carbolic Smokeball Co* [1893] 1 QB 256.

Consequently in applying this objective test, the courts are not concerned with the issue as to whether the offeree had the intention of entering into a contract but that from the given facts and circumstances it was evident that a contract did exist such as in relation to business or commercial contracts. Accordingly this means that there is an offer by one party (the offeror) to another party (the offeree) and that there is a willingness to enter into a contract on certain specified terms in the contract which if in writing requires both parties to sign.

7.12.2 Acceptance (the Agreement)

In respect to the making of the actual agreement, one party must make an offer and the other party must accept the offer. In respect to concluding the agreement, it is imperative that both parties are aware of, fully understand and accept the terms, conditions or promises that are contained in the offer. As an example, if Anton offers to sell his car to Larry for $10,000 and Larry accepts, then they have reached an agreement which is evidenced by the offer and corresponding acceptance. Acceptance occurs at the time that the offeree gives their consent to the actual offer made by the offeror. This means that the actual agreement occurs and takes place when the parties are *ad idem*, that is, when they have reached the point of being 'of one mind' or there has been 'a meeting of the minds'.

7.12.3 Intention to Create Legal Relations

The parties must have intended to be bound and to create a legal relationship that will be enforced by a court of law. Accordingly they must directly or indirectly agree that in the event of a contractual dispute arising between them that the contract will be resolved by a court of law. What the parties have actually intended will often be clear from the nature if their agreement, that is whether they are of a social nature or of a commercial and business nature, and as a result the question of intention will generally not arise. This very important first step in the determination of the creation of an apparent simple contract that was intended to be enforced in a court of law, is illustrated by the cases of *Balfour v Balfour* [1919] 2 ALL ER 760; *Jones v Vernon's Pools Ltd* [1939] 2 All ER 626; and *Merritt v Merritt* [1970] ALL ER 760.

7.12.4 Consideration

Consideration which is sometimes referred to as form of promise to support the negotiation must be provided in every simple contract by each of the parties. The term 'consideration' which is an essential requirement in contract law to support the existence and validity of the simple contract, means that each party must do or promises to do something of value in the agreement for or on behalf of the other party. Consideration is not required in a formal contract which is also known as a specialty contracts as it takes its validity from the special form or manner in which it is prepared such as Deeds and Courts of Record.

The 'form' that is the way that the agreement is entered into and made at law replaces the need for consideration. Consideration generally involves the payment of money but if agreed to by the parties it can take the form of something else that has some value in law even though it may not be adequate. The law requires that consideration must have some 'value' in order to support the contract but it is not concerned with the question of adequacy as this is left to the parties to the agreement.

7.12.5 Legal Capacity

The parties to a valid contract mist have the ability to understand the rights and obligations of their agreement. Accordingly, the parties that enter and make the agreement must have the ability and mental capacity to understand the rights, obligations, nature and of their agreement as well as the consequences of any breaches of the terms and conditions of the contract.

At law individuals under 18 (minors) and those with mental incapacity or disabilities are deemed to be incapable to enter into legally binding agreements for such reasons as intoxication or insanity and are generally not bound by their promises unless there is evidence to suggest that they entered into the agreement when they were 'lucid' and aware of what they were entering into with the other party. For example a minor went to seek employment and signed a written contract which contained harsh and erroneous employment conditions. Due to the age of the minor, that is under 18 and inability to understand the terms of the contract the court will set the contract aside due to lack of understanding.

7.12.6 Genuine Consent

The law requires consent to a contract should be free and voluntary and the element of genuine consent is linked to and refers back to agreement. When the parties negotiate and enter into a contract they must do so in a genuine manner and must honestly agree to the terms. There must also be a 'meeting of the minds' between the parties so that they agree to the same thing under the contract and there is no mistake as to the terms under which the contract was entered into and agreed upon. A party's genuine consent is an essential element of a legally binding contract. Genuine consent to enter into a contract can be affected by a number of factors often referred to as vitiating factors which means that the parties may not have entered into the contract voluntarily and without genuine consent. These vitiating factors includes such things as mistake as to terms and identity of the person, duress, undue influence, misrepresentation, unconscionable conduct, threats and fraud. Each of these factors or events may mean that consent was not freely given by one of the parties and that party may therefore be able to avoid their contractual obligations.

7.12.7 Legality of Purpose and Form

The main object or purpose of the contract must not be illegal and cannot be enforced in a court of law. For example, contracts that are entered into to oust the jurisdiction of the courts or to defraud the taxation department or other contracts that have a hint of 'crime' are illegal at law and unenforceable.

7.13 Different Types of Contracts

As a result of the myriad of contracts that can arise in business and commercial transaction, they have been classified in a number of different ways. This classification essential in order to enable to Law to determine the facts and the way in which the contract was formed and the promise made, the way it was enforced, how it was performed and how it was discharged. Accordingly, contracts are classified in the following way:

- By Promise, that is as either bilateral and unilateral;
- Enforceability, that is if valid, voidable, void, unenforceable or illegal;
- Performance either as executed (present) or executory (future); and
- Formation whether expressly (written), impliedly (prior or past dealings), quasi-contracts (legal obligation arising from law), formal and simple.

7.13.1 Contracts classified by Promise

Contracts that are classified according to the type of promise made between the parties and depending on what the offeree must do to accept the offeror's, offer includes the following:

- **Bilateral** – This is a contract that is entered into by a mutual exchange of promises between the parties, that is, a promise for a promise.
- **Unilateral** – This is a contract in which the offer made by the Offeror to the Offeree can only be accepted by the Offeree, that is 'a promise for an act'.

7.13.2 Contracts classified by Enforceability

Contracts that are classified according to the manner in which they can be legally enforceable consist of the following:

- **Valid** – This means that all of the elements of a valid contract have been satisfied and can be legally enforceable by either of the parties.
- **Voidable** – This means that the contract is valid and binding unless it is rescinded or repudiated by the injured party.
- **Void** – This means that neither party have any rights or obligations under the contract which cannot be enforced by them.
- **Unenforceable** – This means that the contact has a legal *defect* or lacks procedural requirement to make it enforceable.
- **Illegal** – The contract is rendered illegal by operation of statue or common law.

7.13.3 Contracts classified by Performance

Contracts that are classified by the way in which they are performed include the following:

- **Executed** – This means that the obligations arising under the contract has been fully performed by both parties.
- **Executory** – This means that the contract has been partially performed as both parties still have obligations to perform under the contract.

7.13.4 Contracts classified by Formation

Contracts can be classified in respect to the manner in which they are created or formed and includes the following:

- **Expressed** – This means that the contract was created by express words, in writing, orally or a combination.
- **Impliedly** – This means that the contract was created by the conduct or action of the parties, by prior dealings and by operation of the law.
- **Quasi-Contract** – This arises as a result of an agreement giving rise to legal obligations by operation of the Law. They create legally enforceable rights that are based on equity and imposed by law irrespective of whether the parties involved made a specific agreement.
- **Formal Contract** – This is a type of contract that requires a particular format or special way for it to be created and it does not require consideration for it to be valid, as it takes is validity from the special way in which it was created.
- **Simple Contract** – This type of contract must have consideration present for it to be valid, unlike formal contracts.

7.14 Promises in Contracts

In contract law a promise is vital to the issue of intention and enforceability and it is seen as a genuine commitment by a person that something will or will not take place. The person making the promise is called the promisor and the person to whom the actual promise is made is called the promisee. The law presumes, that the parties to a business or commercial agreement actually intend to create legal relations and that they will be legally bound by their promises unless the presumption is rebutted. However, if the parties in a business agreement did not intend the agreement to be legally enforceable then this must be proved in court.

However, the courts do not enforce all promises merely because they are business agreements. This is because there is a significant difference in law between a promise, an agreement and a legally enforceable and binding contract. A promise can be made by one party. However, an agreement requires a 'meeting of the minds' of two or more parties. To be valid and legally enforceable a contract requires more than just agreement and requires: agreement, intention to be legally bound by the agreement and a bargain, called consideration.

7.15 Invalid Contracts

In order for an apparent simple contract to exist it is important that the *all* of the first three essential elements, namely intention, agreement and consideration or form are satisfied and present in the contract. However, an apparent contract is not valid and requires the last four elements to be present before it will be valid, legally binding and enforceable in a court of law. If a contract is invalid because it lacks one of the essential elements it cannot be legally enforceable and is usually classified as either void, voidable, unenforceable or illegal. Contracts are classified according to their validity and these classifications generally suggest that the contracts in dispute are either good, bad or somewhere in between and this distinction is necessary and important as it determines the rights, obligations and remedies that are available to the plaintiff.

7.16 Void Contracts

Contracts that are void do not have any legal status and are sometimes referred to as void *ab initio.* This means that the contract that was entered into by the parties was in fact of no legal effect, empty or bad from the beginning and at the time that was purported to have been entered into between the parties. A contract that is void, lacks legal validity and does not create legal rights or obligations and is generally not supported by any form consideration and was only ever an agreement and not a contract.

The important feature regarding a void contract is under the common law the agreement is deemed to have never taken place between the parties and each party is relieved from any perceived duties, rights or obligations under the contract and walks away with their loss or gain, and the law says that 'the loss falls where it falls'.

7.17 Voidable Contracts

A voidable contract is a contract that has something wrong with it and the parties concerned are able to refuse to perform or carry out any obligations or duties under this type of contract if they wish to do so. A voidable contract is actually valid and binding on the parties until the innocent party decides to avoid the contract. If a contract is rendered voidable, then the injured party has the right which is referred to as rescission, to repudiate that is reject the contract and terminate or end all of the legal obligations under it. Until the party rescinds that is repudiates the voidable contract, it remains valid and legally enforceable such as shares held in the name of infants which can be repudiated when the infant (minor) turns 18 so that they are no longer bound.

7.18 Unenforceable Contracts

A contract that is unenforceable is an actual valid contract that contains all of the essential elements but it is rendered unenforceable at law and the courts will not enforce it as between the parties because it contains a substantive, technical or procedural defect. An example of a technical defect in the contract is the requirement that the contract must be in writing and witnessed. In respect to unenforceable contracts however, the courts sometimes have the power vested to them to enforce an otherwise unenforceable contract if the defect is rectified for commercial reality and viability and to ensure that fairness and equity between the parties especially if the contract is very important and gain lead to sever and significant financial loss and harm if not enforced.

7.19 Illegal Contracts

Contracts whose main aim or purpose is illegal under statute law or common caw, lack the element of 'legality' and accordingly the contract is void. These types of contracts are deemed to be illegal as and will not be enforced by the courts because they may be against public policy or because they are prohibited by statute. Thus, some contracts are rendered illegal by operation of statute law such as racing, gaming and wagering.

Key Points

The key points in this module are:

MO1: **Defining the basis of a valid contract:** A valid contract complies with the laws of contract formation, is executed by people with capacity to enter it and is made in the absence of any common law or statutory vitiating factor that would make it invalid.

MO2: **Explaining when Intention has been satisfied:** Intention to create legal relations has been satisfied when both of the parties to the contract have clearly consented to be bound by the contract and enter into legal relations and the test for intention is generally an objective test based on the standard of the reasonable person.

MO3: **Defining the elements of a valid contract:** The elements to make a contract valid instead of an apparent simple contract are agreement, intention, consideration, genuine consent, capacity, legality and form.

MO4: **Outlining which contracts need to be in writing:** Certain simple contracts are void unless they are reduced in writing by statute to eliminate fraud and include bills of exchange, cheques and payment orders, and real estate contracts.

MO5: **Defining the Parol Evidence Rule:** Is the rule of evidence which states that additional oral evidence is not considered by the courts to vary, add, contradict or subtract from the terms when a contract is *prima facie* complete.

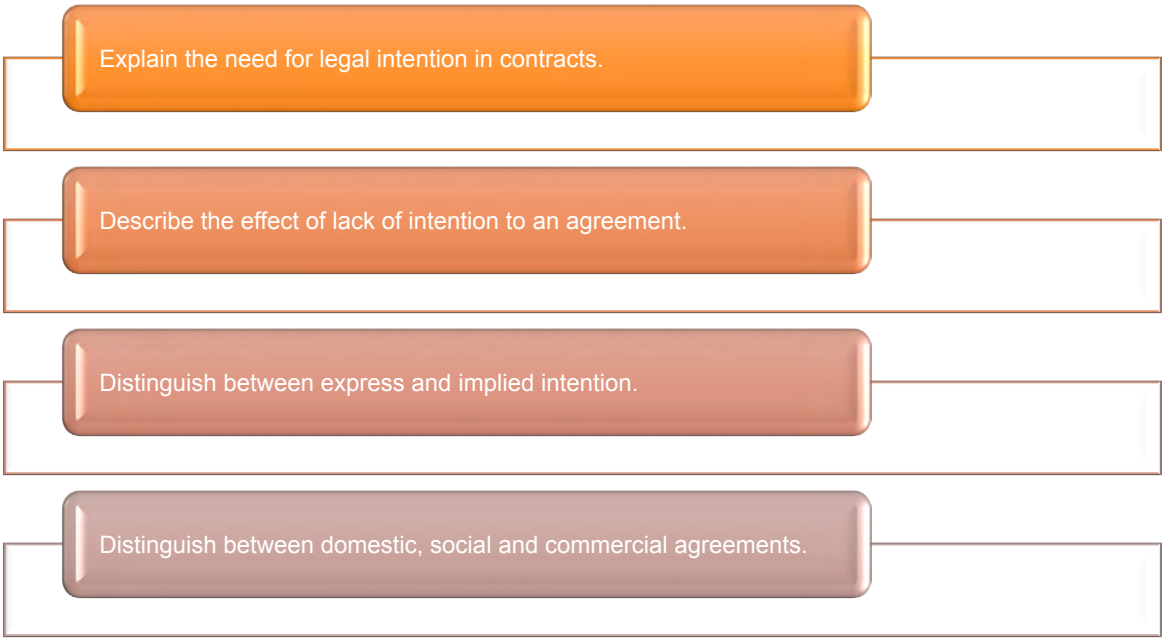
MO6: **Legal Effect of Signing an Agreement:** The legal effect of signing an agreement is that both parties have the intention to be legally bound by the contract that is legally enforceable in a court of law, such as, a business contract. Accordingly they must directly or indirectly agree that in the event of a contractual dispute arising between them that the contract will be resolved by a Court of Law.

MO7: **Understanding other fundamentals of Contracts:** In order for an apparent simple contract to exist it is important that the *all* of the first three essential elements, namely Intention, Agreement and Consideration or Form are satisfied and present in the contract. However, an apparent contract is not valid and requires the last four elements to be present before it will be valid, legally binding and enforceable in a Court of law. If a contract is invalid because it lacks one of the essential elements it cannot be legally enforceable and is usually classified as either Void, Voidable, Unenforceable or Illegal.

Module 8 Legal Intention to Contract

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Domestic Agreements: Arrangements that are made between family members and relatives and do not give rise to legal relations.

Legal Intention: Is a core component of the common law contract. In business arrangements there is a rebuttable presumption that an agreement is intended to create legal relations. However, in domestic arrangements there is a rebuttable presumption that agreements are not intended to create legal relations.

Social Agreements: agreements made between friends or acquaintances.

Voluntary Agreements: agreements where the parties may volunteer their services.

Key Cases

Jones v Vernon's Pools Ltd [1939] 2 All ER 626
Masters v Cameron (1954) 91 CLR 353
Rose & Frank Company v JR Crompton & Bros Ltd [1925] AC 445

Legal Intention to Contract

Agreement on its own does not create nor does it give rise to a contract. An agreement does not bind the parties negotiating its terms, unless the first essential element or step to 'cement' the promise that is, the real and actual intention to create a legal relationship of a valid contract is satisfied. For a valid contract to have been crated, the parties had intended to be bound by their agreement which in the event of a dispute will be enforceable in the courts. Agreement alone therefore, does not create or form the contract. The parties may have reached an agreement but it does not always give rise to a valid contract for a number of reasons. For example, the parties did not actually intend that their agreement would give rise to any legal consequences or were coerced or induced to enter into the agreement.

In most cases what the parties had intended in their agreement is often ascertained from the exact nature or type of agreement. If intention to create legal relations, is missing, the agreement will not have any contractual effect. The parties will then rely on fairness, equitable, moral or social grounds to compel compliance with the terms of the agreement. The test used to ascertain the intention of the parties is an objective test, which means that the courts take into account a number of factors including what was actually agreed, the particular facts, words used and whether both parties acted in a specific manner whereby the law presumes that it is binding and legally enforceable.

8.1 Intention and Agreements

In most situations involving agreements made by the parties, they do not always express (write down) their intentions which can arise orally or by implication. In the most situations, the actual nature of the transaction determines whether the parties intended to create a legally binding contract. If it is still difficult to ascertain if a contract exists from the given facts, then the courts will apply an objective test. This means that the court will look at what the parties to the agreement have expressed (written) or made orally. Also, in some situations the conduct of the parties and other relevant circumstances surrounding the contract apply. The standard of the reasonable person will also be applied by the courts in establishing if the parties had intended to be bound by the agreement. These issues in respect to determining whether intention to create legal relations exists is illustrated by Figure 8.1 Intention to Create Legal Relations.

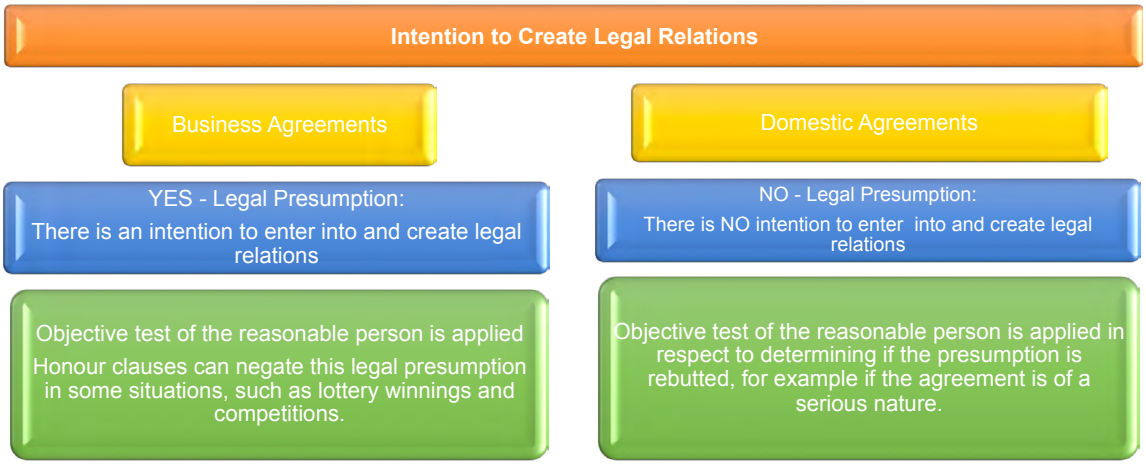


Figure 8.1 Intention to Create Legal Relations.

A legally binding contract is distinguished from other types of arrangements by the element of intention. Even if intention is not present and does not exist, the courts have recently determined that there can still be an agreement but it is an agreement that cannot be enforced by a court of law because the nature of the agreement does not create a contract. In these types of situations involving agreements that do not give rise to a contract because of lack of intention, the parties have no option but to rely on moral or social pressure for enforcement.

However, nowadays, the presumptions test is no longer the most appropriate test for determining intention and consequently suggests the fact that in all agreements being negotiated by the parties there is a genuine need for legal intention. The actual intention of the parties however, to enter into a binding contractual relationship is now determined by taking into account the relevant scope and type of relationship between the parties. By examining the relationship that exists between the parties, implications can be made from that relationship by making a determination in respect of what the parties stated orally, expressed or by actual conduct.

8.2 Legal Intention

Intention to create legal relations refers to the need and requirement that the parties must have actually intended to create legal obligations and to be bound by the terms negotiated. If intention is present the agreement can be enforced in a court of law. If the parties did not perceive, intent or contemplate that their agreement will be binding, there can be no valid contract. Even though the parties have made an "agreement" it does not always mean that a valid contract has actually been created. Agreements on their own do not form contracts between parties. An agreement will only become a contract when the parties have entered into the agreement with the understanding that they had intended the agreement to give rise to legal obligations that are enforceable at law.

In respect to ascertaining whether or not the parties intended to enter into and/or create legal relations the following rules are generally taken into consideration:

- If the contract is of a 'commercial' or 'business' nature then there is the presumption that the contract is in fact intended to be legally binding. The courts in this instance will enforce such agreements unless there is clear evidence to suggest otherwise, by 'rebutting' that is displacing the presumption such as by providing deliberate exclusions in the contract.
- In domestic or social agreements, the general presumption is that the parties do not intend to create legal relations. In this instance, as well, this presumption can be 'rebutted' or 'displaced' by providing clear evidence to suggest that the contract is to be binding and legally enforceable by a court.
- In some situations, the parties negotiating a contractual agreement may purposively avoid any liability under the contract by including an express provision in their agreement that it is not intended to be legally binding, by inserting clauses in the agreement that deliberately excludes liability such as, 'binding in honour only' and other exclusion clauses.

Therefore, intention to create legal relations, which may be express or implied, between the parties is the first essential element that must be satisfied in order for a valid contract to exist. Even though intention may be not be present, there can still be an agreement between the parties, but the difference is that they will not be able to depend on the moral or social pressures that may arise within the situation with the hope for actual performance of the agreement by the defaulting party.

8.3 Express Intention

Parties do not always make actual or direct reference to the element or requirement of 'intention' within the contract. However, where actual reference to intention is made, it is in respect to commercial or business agreements. In situations, such as commercial or business agreements where the parties have actually expressed (written down) or declared orally (spoken) that they intend to be bound by the agreement, there is generally no doubt that intention had existed. However sometimes, terms in the contract, are include that may expressly stipulate that the parties *do not intend* to be legally bound, such as for instance, by the inclusion of specific wording in the negotiated agreement such as: *'binding in honour only or 'honour clauses'*. The cases illustrating this 'express negation' of legal intention is *Rose & Frank Company v JR Crompton & Bros Ltd* [1925] AC 445; *Jones v Vernon's Pools Ltd* [1939] 2 All ER 626 and *Masters v Cameron* (1954) 91 CLR 353.

In *Rose & Frank Company v JR Crompton & Bros Ltd* [1925] AC 445, wherein a commercial arrangement was entered into between the parties, the agreement that was negotiated however, contained an express clause which evidenced the fact that the parties to the contract did not intend to create legal relations and that the agreement was not meant to be legally binding, as such:

> *This arrangement is not entered into, or is this memorandum, written as a formal or legal agreement, and shall not be subject to legal jurisdiction in the law courts…but it is only a definite expression and record of the purpose and intention of the parties concerned to which the honourably pledge themselves….*

Accordingly, the fact that there can be commercial (business) agreements in which there is no actual legal intention, is recognised by law, and is evidenced and established from the case of *Rose & Frank Co v JR Crompton & Brothers Ltd*. In this case there was a very complicated arrangement that was made between an American firm and a number of English companies in relation to the method of doing business together, which was expressed to be a gentlemen's agreement, and was not meant to confer any legally enforceable rights. Consequently, a dispute arose between the parties on the actual agreement that was negotiated, and it was held by the court that those specific words governed the whole agreement and that there was nothing unlawful or against the law in having a 'gentlemen's agreement', which the law recognises in some commercial situations.

Similarly, in *Jones v Vernon's Pools Ltd* [1939] 2 All ER 626 which is an English case involving the loss of a lottery ticket, an *'honour clause'* that was stated on the lottery ticket (coupon) was determined to be effective in actually preventing any legal action being taken against *Vernon's Pools Ltd* by Jones. The situation in this case consists of a commercial agreement of special 'honorary kind', and as such is an agreement which merely confers rights but not actual, legal rights that which cannot be enforced at law, unless there is actual evidence or an acknowledgment of that right such as a validated lottery ticket (or coupon). Therefore, the first condition that arises from the facts of *Jones v Vernon's Pools Ltd* [1939] 2 All ER 626 is this statement (taken from the judgment of the case):

> *'This coupon is an entry form containing the conditions on which it may be completed and submitted to us and on which alone we are prepared to receive and, if we think fit, to accept it as an entry.'*

Essentially, this so called 'binding in honour clause' or simply 'honour clause', is making it evident that these stipulated conditions that will arise within this agreement, will in fact govern the whole relationship between the defendants and anyone who sends or personally presents coupons for claim of lottery winnings. This led to the second important *'binding in honour clause'*, namely:

> *'It is a basic condition of the sending in and the acceptance of this coupon that it is intended and agreed that the conduct of the pools and everything done in connection therewith and all arrangements relating thereto (whether mentioned in these rules or to be implied) and this coupon and any agreement or transaction entered into or payment made by or under it shall not be attended by or give rise to any legal relationship, rights, duties or consequences whatsoever or be legally enforceable or the subject of litigation, but such arrangements, agreements and transactions are binding in honour only.'*

Additionally, in *Masters v Cameron* (1954) 91 CLR 353 the courts also accepted that such *'binding in honour clauses*' or *'honour clauses'* are capable of evidencing that the parties did not intend to create legal relations even by words such as: *'this agreement is subject to contract' or 'subject to the preparation of a formal contract of sale which shall be acceptable to my solicitor'.*

In the event of a contractual dispute when the agreement has been expressed or declared the courts generally do not have any difficulty making a determination and giving effect to what was expressed by the parties. Accordingly, express intention is embedded in the agreement that is negotiated between the parties by the inclusion of terms that expressly and clearly indicate that the parties do not intend to be legally bound such as for example by the inclusion of 'honour clauses' and 'exclusion clauses'. It is very difficult for the parties that are involved with a business or commercial agreement to rebut, displace or overcome the usual presumption surrounding these types of agreements because the courts generally regard that in these types of agreement, there is the real intention to enter into and create legal relations.

8.4 Implied Intention

Even though the intention to enter into a binding and legally enforceable contract is the first essential element in order to constitute a valid contract, it does not always mean that the parties who are making the agreement are actually aware of the things they say or write them down. In most situations where agreements have been entered into, the intention of the parties whether to be bound is not evident or clearly established. This means that the parties may not have clearly shown whether they intended that their Agreement was to be legally enforceable or not.

In these situations the courts have to determine from the facts and circumstances surrounding the agreement whether the agreement was intended to have contractual force and to be legally binding and enforceable in a court at the time when it was entered into immediately by the parties. The courts therefore are unable to determine exactly what the parties had intended when their agreement was made and cannot simply relay on the words of the parties. Consequently the courts must ascertain if there was a real intention to enter into a legally binding and enforceable contract and this is done by looking at the *physical evidence* surrounding the circumstances that gave rise to the agreement.

Accordingly in order to establish if intention was meant to exists, a court by examining the *physical evidence* will take into account the following:

- Anything that was written down in the agreement;
- Anything that was spoken by the parties;
- The actual manner in which the parties conducted themselves;
- The effect and/or consequences of the agreement on the parties; and
- All the relevant surrounding circumstances.

After examining all of the *physical evidence* the court must decide if there is sufficient evidence based on the objective test of the reasonable person as to whether the parties had actually intended to be legally bound or not be legally bound by their agreement. The type of agreement that was entered into is examined by the courts to assist in determining if the parties had intended to be legally bound by their agreement and are normally classified as being either of a:

- domestic/family/social nature; or
- business/commercial nature

In relation to these agreements the Law applied two important *presumptions* in determining intention, and these presumptions that apply to agreements which are *rebuttable* (meaning that these presumptions can be overturned or proved to be wrong) if one of the parties can provide enough evidence showing the opposite intention, are that the:

- Parties to the agreements that are of a domestic, family or social nature *do not intend* to create legal relations.
- Parties to agreements concerning commercial or business matters *do intend* to create legal relations.

8.5 Non-Commercial Agreements

Under contract law there are three types of agreement that generally lack any serious intention by the parties to enter into and create legal obligations that are recognised and enforceable by a court of law. In each of these three types of agreement, the general inference is that the parties from the actual nature and type of agreement and taking into account the parties involved, usually family and friends, is that the parties would not have intended legal relations.

These three types of non-commercial agreements are:

- social agreements – which are agreements that are made between friends or acquaintances, such as in relation to competitions and lotteries;
- family or domestic agreements – which are agreements that are made between family members and relatives and not just husband and wife;
- Voluntary agreements – where the parties have volunteered their services for no financial gain or remuneration.

8.5.1 Domestic Agreements

Domestic, family or social agreements are normally entered into between family members and relatives. These types of agreements usually include a wife and husband arranging to meet for dinner or a father promising to pay his son $5,000 to obtain excellent grades in his University studies. In respect to these types of agreement the presumption is that they are not intended to create legal relations between the parties and courts are reluctant to rebut this presumption unless there is clear evidence to suggest otherwise, such as the seriousness of the agreement. In respect to these types of agreement the traditional view is that such disputes are considered of a private nature and that they should be settled in an amicable manner without resorting to the courts, such as in respect to agreements between a husband and wife. The courts consider domestic arrangements between husband-and-wife to be social agreements and not legally enforceable.

However, it should be noted that in certain situations this presumption can be rebutted if there is strong evidence to show that the arrangement is in fact commercial in nature such as where the arrangement involves some form of monetary considerations or involves arrangements that involves the payment of maintenance allowances. Similarly with husband-and-wife arrangements, agreements that are made between family members are generally presumed not be legally binding because the parties do not generally intend to create legal relations. This presumption is analogous to husband-and-wife arrangements in that the presumption operates to minimise the need for such disputes involving family arrangements to be settled without resort to litigation in the courts.

8.5.2 Social Agreements

In respect to social arrangements, it is generally not difficult to infer that generally parties had never actually intended that legal relations were actually being created. However, this general presumption an also be rebutted or displaced, if there is strong evidence to suggest that there was intention to create legal and binding relations between the parties. Friends, family members and work colleagues often get together and form a social lottery syndicate to buy lottery tickets, enter pools or other games of chance such as 'Lotto'. In some special situations, a social lottery syndicate agreement would probably create legal relations that are binding and legally enforceable by the courts. For instance, agreements that are made between parties to take part in competitions and lotteries may appear to be just social and friendly agreements as between the parties involved. However, there can be more serious consequences involved which may in the event of a win, that the parties had an intention to create legal relations. This would mean that the plaintiff would have to establish on the balance of probabilities (civil action) that eh parties had anticipated that in the event of a win the proceeds would be shared between all the parties and the courts would ascertain this if it is clear that the parties had contributed often and regularly to the purchase of a ticket.

8.5.3 Voluntary Agreements

Voluntary agreements refer to agreements where the parties volunteer their services. In these types of situations, where there is voluntary participation in charitable or other voluntary organisations, the parties involved do not usually intend to create legal relations. Instead in these types of situations the parties have entered into an agreement but it is usually very clear from the circumstances that surround the agreement that at the time of entering into the agreement, a legally binding and enforceable contract was not intended and this situation especially where one of the parties is merely volunteering their services for no financial gain or remuneration.

8.6 Business (Commercial) Agreements

In business or commercial agreements it is generally presumed that the parties had actually intended to create legal relations. This presumption is derived from the actual nature of the agreement which deals with commercial or business agreements and the specific relationship between the parties involved. Accordingly, within these types of business arrangements there is a very strong, definite and clear presumption that there was a real and actual intention by the parties to create legal relations which will be enforceable in a court of law in the event of a dispute. Under this type of agreements any person who is involved and who attempts to claim that there was no intention to create a legally binding agreement would encounter some difficulty. Even though the presumption that generally there is intention to create legal relations in business or commercial agreements can be rebutted or displaced, it is usually very difficult to rebut this presumption.

8.6.1 Intention (Business/Commercial Agreements)

For a contract to be legally enforceable it is clear that there must be a real intention to be legally bound. In commercial and business arrangements the presumption is that the parties do intend to create legal relations. This presumption is made on the basis that money or other financial gain or benefit is involved and or arises from the business or commercial agreement entered into between the parties. When there is money involved or other form of valuable consideration, then the courts are more likely to ascertain the necessary element of intention to create legal relations.

8.6.2 Business Presumption

As mentioned earlier, money is not the only determining factor for the courts to ascertain if a commercial presumption does in fact exist in an agreement between parties. In this regard and to ascertain whether or not there is a commercial or business agreement in place between the parties, the courts apply an objective test and take into account the following factors:

- whether the agreement is at 'arm's length';
- the context of the agreement/arrangement;
- the parties involved in the arrangement;
- the exchange of money;
- the size of the transaction;
- the subject matter of the contract;
- the use of legal terms;
- the documentation used by the parties; and
- The involvement of third parties.

All of these factors are extremely important and relevant in ascertaining whether the courts will make a determination in establishing the existence of the commercial presumption when an agreement is in dispute as to whether or not a commercial or business agreement had been entered into between the parties.

8.6.3 Rebuttal of Commercial Presumption

Even though the general presumption in commercial or business agreements is that the parties did intend to enter into legal relations and create legal intention which can be enforced by a court of law, the commercial presumption may be rebutted under special circumstances. Once the commercial presumption has been ascertained and established, it can be rebutted or displaced by not only the circumstances of the particular case or agreement but also when there is clear evidence and proof to suggest that one of the parties to the agreement expressly excluded legal relations. The express exclusion of the commercial presumption in agreements between parties can be rebutted or displaced by a number of ways including the following methods by:

- express use of the phrase 'this arrangement is not intended to be legally binding';
- Agreement is to be binding in 'honour only' (honour clauses);
- Agreement 'need not be subject to litigation'.
- Conditional agreements; and
- 'Subject to contract' clauses.

If the courts determine that the parties did not actually intend their agreement to be legally binding then the consequences of a lack of legal intention on the agreement between the parties will be as follows:

- There was no contract whatsoever and the alleged contract is void *ab initio* (void from the beginning);
- There are no legal rights or obligations as between the parties;
- The parties cannot seek monetary compensation in the form of damages, specific performance or other remedies for the alleged breach of the agreement; and
- No ownership of property can pass under such an agreement.

Key Points

The key points in this module are:

MO1: **Explaining the need for legal intention in contracts:** In order for an agreement to be legally enforceable as a contract, one of the conditions that must be satisfied is that the parties intended to create legal relations. Intention in a contract can take the form of express (words, writing or conduct), or implied (conduct or prior dealings) and it if is not present then there is not valid contract.

MO2: **Describing the effect of a lack of intention to an agreement:** If there is a lack of intention to an agreement even if all the other elements of a contract are present, then there can be no contract and the parties will have rely on moral or social pressure for the enforcement of the agreement.

MO3: **Distinguishing between express and implied intention:** Express intention is where the parties make direct or express reference to the question of intention in the contract by way of a term. Implied intention arises where the express intention of the parties is not expressly stated and here the court has to try and determine what it was that the parties intended from their words and/or actions.

MO4: **Distinguishing between domestic, social and commercial agreements:** The law has treated agreements as falling into one of two categories, namely commercial or business agreements; or non-commercial, that is, social, family, domestic or voluntary agreements. Thus, the determination of intention was then resolved by reference to rebuttable presumptions of fact. In the case of commercial or business agreements, the law presumed that the parties did intend their agreement to create legal relations. In the case of non-commercial agreements, the presumption was against intention – that is, the agreement was *prima facie* unenforceable.

Module 9 The Offer

Module Objectives

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

Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Invitation to Treat: Is not an offer and, unlike an offer, cannot be accepted.

Negotiation: is a mutual discussion and arrangement of the terms and conditions of a transaction or agreement between two or more parties.

Offeree: the one to whom an offer made.

Offeror: the one who makes the offer.

Key Cases

Adams v Lindsell (1818) 106 ER 250
Balfour v Balfour [1919] 2 ALL ER 760
Butler Machine Tool Co Ltd v Ex-Cell-O Corp (England) Ltd [1979] 1 WLR 401

Byrne and Co v Van Tienhoven (1880) 5 CPD 344
Carlill v Carbolic Smokeball Co [1893] 1 QB 256
Clarke v Dunraven [1897] AC 59
Dickinson v Dodds (1876) 2 Ch D 463
Entores Ltd v Myles Far East Corp [1955] 2 QB 327
Felthouse v Bindley (1862) 11 CBNS 869
Goldsborough Mort & Co Ltd v Quinn (1910) 1 QB 674
Gray v Pearson (1857) 6HLC61; 10 ER 1216
Grainger and Sons v Gough [1896] AC 325
Hartley v Ponsonby (1857) 7E & B 872
Jones v Vernon's Pools Ltd [1939] 2 All ER 626
Masters v Cameron (1954) 91 CLR 353
Merritt v Merritt [1970] ALL ER 760
Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd [1953] *1 QB 401*
Ramsgate Victoria Co Ltd v Montefiore (1866) LR 1 Exch 109
Routeledge v Grant (1828) 4 Bing 653
R v Clarke (1927) 40 VLR 227
Smith v Hughes [1960] 1 WLR 830
Stilck v Myrick (1809) 2 Camp 317
Stevenson Jacques and Co v McLean (1880) 5 QBD 346

The Offer

When it has been established that the parties satisfied the first and essential element of a contract, that is they actually intended to create legal relations, it is then necessary to determine if the parties have reached an agreement. In respect of the law of contract it is necessary that there is a 'link' or 'connection' between the two sides of the agreement that was negotiated by the parties. This simply means that the parties must have 'consensus' (agreement) in that they have the same thing in mind.

Essentially, this means that there must be an offer that was made by one party called the offeror, to another party, called the offeree. Apart from the presence of the two parties and the agreement being negotiated, there must also be a corresponding voluntary willingness and intention to enter into the contract on specific terms as negotiated between the two parties. An offer therefore in contract law refers to a definite undertaking or commitment that is clear and precise between the parties, and which is genuinely made with the mutual understanding and intention that it will become binding on the person making the offer, the offeror once it is actually accepted by the offeree and hence a contract is formed upon acceptance of the offer.

THE OFFER

- An offer that is made by the Offeror to the Offeree must be communicated and silence does not constitute acceptance.
- An offer may be made to a single person or class or persons, or to the world at large. See *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256
- An offer must be distinguished from an invitation to treat (which is an invitation to consider offers) and from an option.
- An offer may be revoked at any time before actual acceptance of all the terms and conditions.

9.1 Legal Meaning of Offer

An offer refers to a clear expression of terms under which a person is prepared to enter into a contract with another person and to be bound by accepting the negotiated terms and conditions. Essentially, the offer creates in the offeree the ability to create a contract if they accepts the offeror's terms unconditionally. Offers should always be clear, certain, understood and final in order for there to be a corresponding acceptance on the specific terms of the offer. The essentials of a binding contract is the existence of a firm offer and acceptance. They are the standard categories which are used in contract law to indicate if there is agreement between the parties. This provides a useful indicator and form of analysis in ascertaining if there has been an offer and corresponding acceptance as well as directing attention to the aspect of agreement, that is, at what stage that it arise and on what terms.

An offer is defined as a legally binding promise that is made by one party, the offeror to another party the offeree. An offer is a proposal to make a deal. An offer must be communicated to another person, and it remains open until it is accepted, rejected, retracted or has expired. A counter-offer closes the original offer. The offer will contain terms, which are elements that help define the scope of an agreement. Terms for other contracts must be specific and definite because the offer has to identify the basic obligation of the contract. When an offer has been actually accepted, and this forms the agreement, then provided that all of the other essential elements of a valid contract are met, then a valid and legally binding contract comes into existence and is enforceable by a court as is illustrated by Figure 9.1 Nature of a Contract.

Accordingly, an offer exists only where a reasonable person would conclude from the given facts and circumstances that the person was willing to be bound in a court of law. An offer that is made by the offeror is not valid unless it satisfies these following rules:

- the offer must be communicated to the offeree;
- offers may be made to an individual, a group or class or people or to the world at large;
- there must exist and be created a firm offer and not an invitation to treat;
- a request for information does not give rise to an offer;
- an offer is different to an option; and
- the offeree must be aware of all relevant terms and conditions.

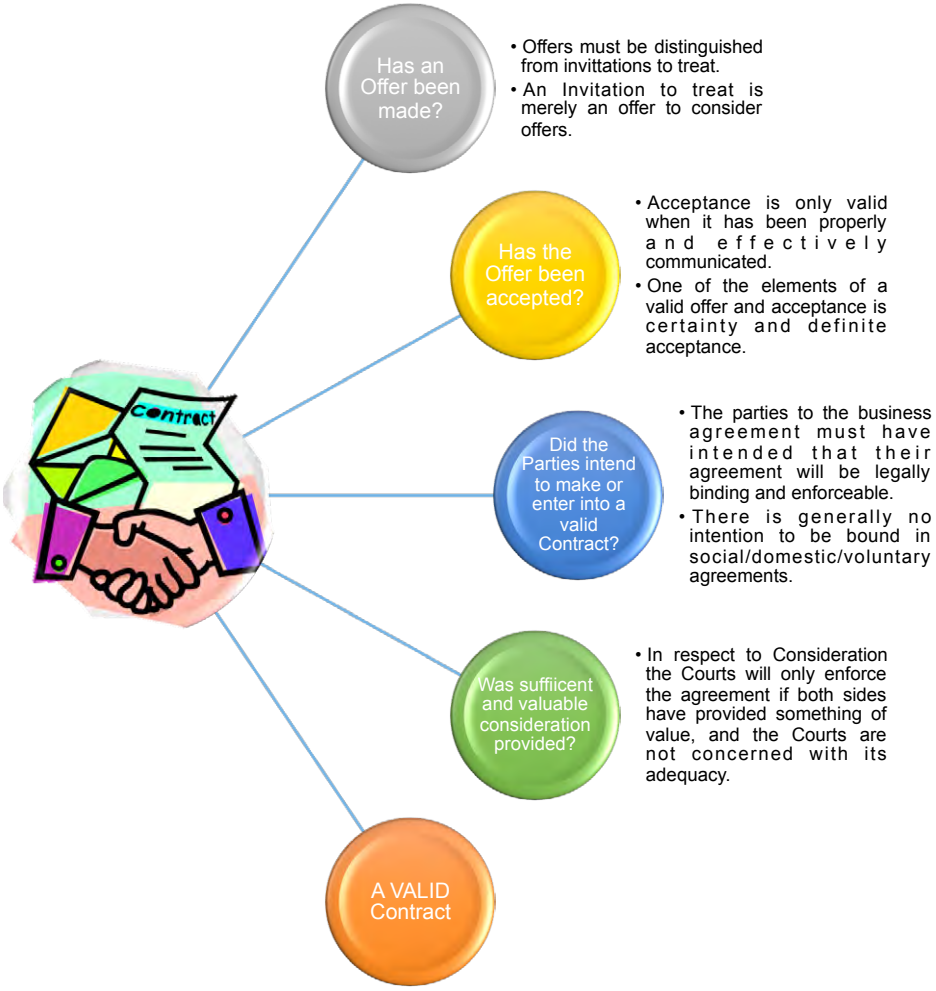


Figure 9.1 Nature of a Contract

In respect to the above distinct elements or rules in respect of offers, it should be highlighted that Offers are different to and should be distinguished between the following, an indication of future conduct (mere statement); an invitation to treat and negotiations.

9.2 Offer or Request for Information

An offer can only exist if there is a firm promise between the parties to do or to refrain from doing something between them. If there is no actual firm or agreed promise, then there is no offer and no agreement. Accordingly, in situations where an "offeror" makes a statement that is only intended to supply information upon which some future dealing may or may not be negotiated than that statement is not an offer and it cannot be made binding by acceptance.

Therefore, the mere supplying of information, whether in response to a request or not, is not an offer to deal as between the parties. The legal principle at law is that a mere statement of a present intention to do something in the future is not an offer. As stated earlier, this means that a just a response to a request for information may not constitute an offer. If a party simply supplies any information that has been requested than it is usually not regarded or viewed as a genuine offer by the courts and is illustrated by the case of *Stevenson Jacques and Co v McLean (1880) 5 QBD 346*.

It is essential to distinguish a counter-offer which operates to terminate or destroy the original offer from a mere request for further information, because mere requests or additional information does not destroy the original offer. Thus, if there is no firm promise in the agreement, then there is no rejection of the original offer by the counter offer. In respect to a request for additional information which is based on future conduct, the law states, that a person who merely asks for information is not making an offer, and nor is the person who provides the information that is requested during the negotiations making any kind of offer.

9.3 Invitation to Treat – Level 1

An invitation to treat is not an offer and it must be distinguished from an offer. An invitation to treat arises when parties to a contract express an interest in doing business without intending to be legally bound at this early stage of the negotiation. The term '*treat*' is an old English term for a bargain or negotiation. A party to an agreement issues or makes an invitation to treat depending on the situation and type of contract being negotiated, if an interest is expressed in doing business with someone without the actual intention of being legally bound at these initial stages and this area of law of contract in respect to acceptance is illustrated by *Grainger and Sons v Gough* [1896] AC 325 and *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd* [*1953*] *1 QB 401.*

Generally, however invitations to treat which is a negotiation to make an offer often actually lead to firm offers being made. Accordingly, in contract law, an invitation to treat is often described as 'an offer to consider offer' or 'an invitation to make an offer'. The distinction lies in the objective intention of the person making the offer or invitation to treat.

9.4 Offers and Invitations to Treat

Offers are distinguished from non-offers such as an invitation to treat. An invitation to treat is as explained above, not a genuine offer but is an 'invitation to treat', that is an 'offer to consider offers', because it is only in the form of an invitation to make an offer which can be accepted or rejected by the person making the offer, the offeror. Sometimes what may appear to be an offer is not a firm offer, as it does not contain either expressly or impliedly a firm declaration or promise by the offeror that the actual offer will in fact be honoured upon its acceptance. In this instance, there is only a statement of purported intention to contract on specific terms but only if the other party accepts those terms and is willing to be bound by those terms.

The statement then is not an offer but simply an invitation to others to merely consider the offers being made, hence its reference as 'invitations to treat'. The distinction between an offer and an invitation to treat is necessary and beneficial when conducting business or commerce and operates as a protective mechanism for the shop owner, in situations where he cannot supply all demands by those accepting, otherwise it can constitute a breach of contract which is an absurd and unrealistic commercial expectation. There are many examples of an invitation to treat that take place each day in various forms. Some examples of an invitation to treat include, retail displays, catalogues, advertisements, auctions and tenders.

9.5 Shop Displays

Displaying goods in a shop amounts to an "invitation to treat". In most circumstances the retailer does not make an offer by displaying goods for sale, even where the goods are marked with a price. Generally, goods that are displayed in shop windows or shelves which are considered to be invitations to treat and not form offers sell. In this situation the store or shop owner is merely inviting offers to be made and the actual offer to buy is made by the customer when he or she pays money, being the consideration to the cashier.

At this point there is no sale transaction until the shop owner actually accepts the money in payment for the good and thus a valid contract is formed; or if the shop owner refuses to accept the money being offered just keeps the good. In this instance, the shop owner is able to have a choice of refusing or accepting the money from the prospective buyer because the actual display, whether it is in a shop window or on a shelf, is not an offer to sell. Ultimately, it is up to the shop owner to decide if the customer's offer to buy will be accepted, and if it is, then at the point of exchange of the price for the good, a legally binding contract is formed.

Alternatively, it could be argued that the selection of goods is an "act" in response to the offer which completes a unilateral contract. Where a product in large quantities is advertised in a newspaper or on a poster, it may be an offer, but generally speaking it will be regarded as an invitation to treat, since even when large stock is held it is still limited, whilst the response to an advertisement may be unlimited. Similarly, a display of goods in a shop window is an invitation to treat, with the offer being made by the purchaser at the checkout and being accepted by the shop assistant operating the checkout.

9.6 Catalogues

An invitation to treat also includes price lists, circulars and catalogues, unless the seller expressly or impliedly had promised to the purchaser or purchasers (where more than one acceptor) to supply everyone who had placed the order. If the catalogue publisher was making an offer then it would be bound by every acceptance even if their stock was exhausted and this would cause a breach of contract due to non-supply which would lead to an absurdity and unfair situation on behalf of the seller.

9.7 Advertisements

A brochure or advertisement is an attempt to solicit offers, but does not constitute an offer in itself and if it was, the commercial consequences would be too complex and very difficult to monitor and enforce. Under the common law advertisements are generally classified as invitations to treat and they are not legally binding and if they are to be legally binding it ddepends on the individual circumstances.

The very famous case of *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256 illustrated that advertisements that are circulated to the 'world at large' such as in newspapers, magazines, radio or television are in fact classified as being offers if they actually state or imply that they intend to be legally bound by the promises made and contained in the advertisements to any person who buys the goods or services and who satisfies and accepts any of the terms and conditions that are contained in the advertisement.

9.8 Auctions

There is no doubt that in an auction, it is the bidders who make offers and the auctioneer who is free to accept one of those offers. An auction is where property of some sort is put up for sale and people then make successive bids, and the highest bidder usually becomes the purchaser. In auctions the auctioneer's request for bids is an offer, and that each successive bid is a conditional acceptance, that is, a completion of a contract, subject to there being no further higher bids. Alternatively, it could be said that it is the bidder who makes the offer, and that the acceptance is then provided by the auctioneer, who signifies acceptance of the highest bid in the traditional manner of banging the hammer, or by some similar gesture. In an auction which is a public sale of property through the process of 'bidding' for the goods on offer, the bidder makes the offer and the auctioneer accepts.

It is common practice that the auctioneer announces terms at start and then anyone who bids then accepts the auctioneers offer as to terms when the bid is finished when the auctioneer closes the bid. In essence what the auctioneer is doing by asking for 'bids' is not making a firm offer, but is issuing an invitation to treat and when the bidders actually indicate that they want to buy the goods for the specified auction price then they are making an offer. The contract takes effect and is created when the auctioneer accepts the highest bid, which is usually when he bangs the hammer down for the last time and closes the bidding as is illustrated by Figure 9.2 Auction as an Invitation to Treat.

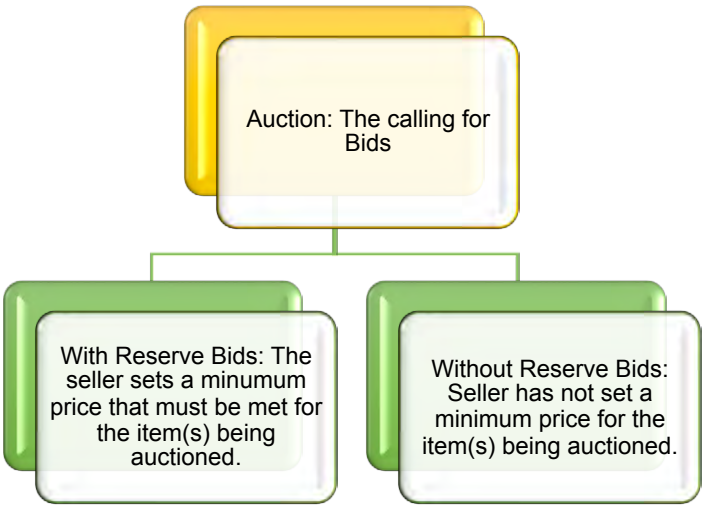


Figure 9.2 Auction as an Invitation to Treat

9.9 Tenders

Tenders are generally common in government and commercial contracts. A tender is generally not an offer and is like an invitation to treat as it invites interested parties to submit (tender) quotations or offers in order to provide services or goods for a specific commercial activity, building or other enterprise. The person submitting the tender makes the offer and the government department or business that is calling for tenders accepts any tender, but it is not bound to accept the lowest tender and any request for tenders may be an offer to deal with tenders in a certain manner.

There are two main types of tenders:

- specific purchase tenders – such as for example, a government department wants to purchase six new computers and invites tenders in accordance with specification and the advertisement may be seen as invitation to treat, the tender is then an offer which the department may accept or reject; and
- tenders for 'requirement contracts' – such as for example, the government department wants someone to tender for the supply of computers "as required". The tenderer puts in a price for each of the computers and if the department accepts, then they actually have a commitment to place an order, but it may however, have the option to order from other suppliers. This in fact means that there is not the completion of a contract, but the putting in place of a "standing offer" for consideration.

If on the other hand an advertisement asks for tenders, then the advertisement may be seen as an invitation to treat. Where a tender is submitted on an "as required" basis, then it may be seen as an offer to supply at set and specified price. In the given situation if for example, the government department actually states that the supplier has a contract, there is still no contract in law, because there is no legally binding commitment on either side. Therefore, when the department places an order for a specified number of computers, or other thing for which a tender is placed in the wider community and marketplace then it amounts to the acceptance of standing offer contained in the tender, and it may amount to the completion of a contract at this point of the negotiations.

9.10 Negotiating Contracts

Offer and acceptance are a way of determining the process of negotiation to decide whether and when a contract has been made and what therefore constitute its terms. The standard or traditional approach to contract law states that all contracts require there to be an offer and an acceptance. Given that the courts will go on to state that the details of the bargain and the adequacy of consideration are not for them to assess, or determine, this amounts to a formalistic, or due process view of contract law.

Accordingly, where a party's conduct is such that a reasonable person would believe that there is an unambiguous assent to the terms as proposed, that party is then prevented (estopped) from asserting their true intention, assuming it to be otherwise, and is bound by the contract as if they had intended to agree. Thus, in the situation regarding the negotiation phase of the offer it should be noted that:

- An offer will not arise merely because parties have reached agreement on one aspect of the deal
- Implied (or express) understanding that parties not bound until formal contract executed
- Heads of Agreement often state the terms upon which the offer has been agreed to being negotiated between the parties before it becomes accepted and formed into a valid contract.

9.11 Meaning of Negotiation

A negotiation is a mutual discussion and arrangement of the terms and conditions of a transaction or agreement between two or more parties as is illustrated by Figure 9.3 Nature of Agreement. Generally an offer will not arise merely because parties have reached agreement on one aspect of the deal and there may be an implied (or express) understanding that the parties to the agreement will not bound until a formal contract has been effectively agreed to and formally executed in a contract that is commonly referred to as, "Heads of Agreement". However, in the process of negotiating a contract between the parties, the concept or idea of an offer is not ascertainable in some situations, as the parties cannot agree on the simple question of who made the offer and who is actually accepting the offer. Sometimes in the actual negotiation it is difficult to determine if a statement that was made by one of the parties gives rise to an offer or if it is merely providing information that is in response to a request for information.

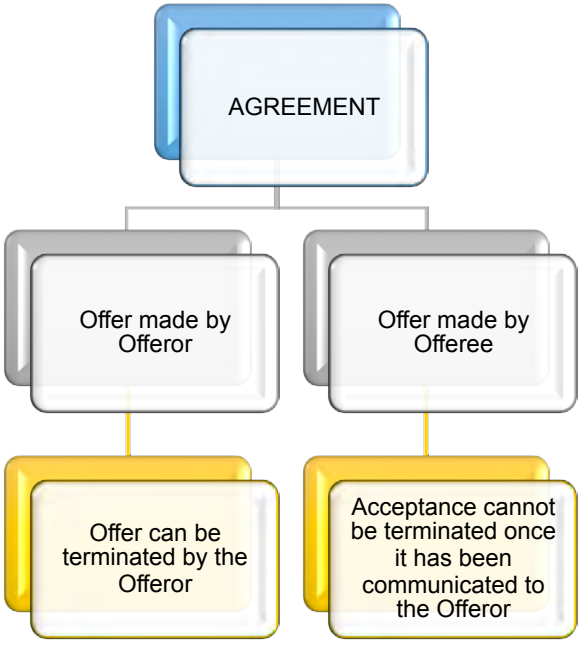


Figure 9.3 Nature of an Agreement

9.12 Termination of Offer

The general principle or rule regarding the termination of an offer is that an offer can be terminated at any time before acceptance of the offer has taken place. Therefore, once it has been accepted the offer cannot be terminated. An offer generally remains open until it has been actually accepted or it has lapsed. When an offer lapses, it comes to an official end under contract law and it does not legally exist any longer. Accordingly that offer has no effect and cannot be accepted by anyone else.

An offer can lapse or it may be terminated in any one of the following ways listed below and as illustrated by Figure 9.4 Methods of Termination of Offer:

- Revocation or withdrawal by the Offeror: *Dickinson v Dodds; Routeledge v Grant and Byrne v Van Tienhoven*
- Accepted by offeree: *R v Clarke*
- Rejection by offeree
- Lapse due to passing of time
- Lapse due to death of offeror or offeree: *Fonq v Cilli*
- Lapse due to failure of condition precedent

9.12.1 Revocation of Offer

Generally an offer cannot be withdrawn after accepted as a contract is made when the offer is accepted. Also the withdrawal of the offer must be communicated to the offeree and there are certain special cases of offers which are not actually offers or give rise to difficulty in respect to being able to be revoked and include unilateral offers and options (deposit, the consideration, to hold offer open) which cannot be withdrawn. This aspect is illustrated by the cases *Byrne and Co v Van Tienhoven* (1880) 5 CPD 344; *Dickinson v Dodds* (1876) 2 Ch D 463 and *Routeledge v Grant* (1828) 4 Bing 653.

The offeror is able to revoke or withdraw an offer that has been made to an offeree even if the offer contains a promise that it will not be revoked for a period of time. The effect of a revocation is that it caused an offer to lapse, or come to the end of its life. In order for the revocation or withdrawal to be effective it must be actually communicated to the offeree otherwise it is ineffective. The offeror in this instance does not have to actually communicate the revocation as it is sufficient notice if the offeree hears of the revocation from another independent third party in situations where it would be reasonable and where a reasonable person would accept the communication from the third party as being true and taken seriously.

Revocation in unilateral contracts cannot occur easily and is very difficult to have an effective revocation or withdrawal of unilateral contracts as it is difficult to ascertain when the offeror is able to withdraw the offer. Traditionally, a unilateral contract is one in which acceptance occurs when the offeree performs the specific act that is required in the offer. Nowadays, the preferred view is that there is in fact an implied promise or undertaking not to revoke the offer after the offeree has actually commenced performance of the specific act or conduct as instructed by the terms of the offer.

9.12.2 Options

Generally, an offeror may withdraw an offer at any time before acceptance. However options (which are not offers) cannot be withdrawn, as an option is a separate enforceable obligation and cannot be withdrawn and exists where the offeree has given consideration (money) to keep an offer open as is illustrated by the case of *Goldsborough Mort & Co Ltd v Quinn* (1910) 10 CLR 674. Thus, an "option" is not an offer but if some value is given to it such as in the form of a deposit (money) it then becomes a binding promise and has the effect of keeping of an offer open for a specified period of time, such as when buying a motor vehicle. Another common example of an option in practice is where the owner of land provides a prospective buyer with a written option to buy their property.

9.12.3 Counter Offer

When an offer is received it can be accepted or rejected by the offeree and once rejected cannot be accepted any longer. This means that if an offer is rejected, the offeree is not able to later reconsider and accept it due to its initial rejection as is illustrated by *Butler Machine Tool Co Ltd v Ex-Cell-O Corp (England) Ltd* [1979] 1 WLR 401; and its subsequent revocation as is illustrated by the cases of *Byrne and Co v Van Tienhoven* (1880) 5 CPD 344; *Dickinson v Dodds* (1876) 2 Ch D 463 and *Routeledge v Grant* (1828) 4 Bing 653. If the offeree tries to accept a rejected offer, the law says that it is not an acceptance and there is no offer in existence to accept, and it is simply a new offer that the original offeror can either accept or reject without any legal obligations to the offeree. An offer that is received is normally accepted by an affirmation and saying *"Yes. I accept the offer";* or it can be rejected by non-affirmation and by saying, "*No, I do not accept your offer*".

Apart from these ways of accepting or rejecting an offer that has been made, an offer can also lapse if the offeree makes a counter offer or makes a qualified acceptance to the initial offer that was made by the offeror. Generally, once rejected, an offer cannot be accepted and it may be rejected expressly or by implication, that is by the offeree's actions which are inconsistent with an intention to accept. A counter offer is a rejection, that is, it is a response that indicates a willingness to enter into the contract but in a different form.

9.12.4 Lapse of Offers

Offers can lapse as a result of a number of situations which means that there has been no contract formed as there has been no acceptance and this legal principle is illustrated by *Ramsgate Victoria Co Ltd v Montefiore* (1866) LR 1 Exch 109 and *Fonq v Cilli* (1968) 11 FLR 495. The other situations that cause offers to lapse include the following:

- **Lapse by the death of a party** – An offer generally lapses due to death of either party unless it is in the form of an option, and the offer does not involve personal skill or service by the deceased. It is clear that an offeree cannot accept an offer when they have notice of the fact that the offeror has died and the notice effectively terminates the offer.
- **Lapse Due to failure of condition precedent** – Offers can sometimes be made that are subject to specified conditions, such as 'subject to finance'. Accordingly, if an offer is made and it is subject to a condition, the offer will automatically lapse if the condition is not satisfied, such as the condition precedent. If the condition is not fulfilled, then the offer lapses, unless the condition is waived by the offeror. In respect to conditions, difficulties often arise where an offeree has to meet some condition before they are able to accept the offer, and for some unforeseen reason they cannot satisfy the condition. In these instances, if the condition is not waived, there is nothing the offeree can do as acceptance is not possible because the condition precedent to the actual right to accept has not been fulfilled and the offer lapses due to failure of the condition precedent.
- **Lapse by passing of time** – An offer that requires acceptance within a specified time automatically lapses when that time expires. Accordingly an offer that does not contain any time limit for acceptance lapses after a reasonable time as accepted within the given situation and may be seven days, fourteen days or longer if it is normal practice in that commercial business or industry, and so what constitutes reasonable time depends on the circumstances. Due to time or express time limit should be mentioned during the offer, otherwise, offer remains open for a reasonable time. What is reasonable time depends on:
  - Method by which offer made
  - Nature of the transaction
  - Terms of proposed contract
  - Actions of parties between offer and purported acceptance
  - Intimations as to time by offeror

Figure 9.4 Methods of Termination/Revocation of Offer.

Key Points

The key points in this module are:

MO1: **Explaining the nature of a contract:** A contract is a legally enforceable agreement.

MO2: **Explaining the need to establish if the parties have reached an agreement:** There is a need to establish if the partiers have reached an agreement and have freely consented to be bound by the valid and enforceable contract.

MO3: **Explaining the concept of Agreement:** Agreements do not lead to enforceable contracts unless there has been an offer made with a corresponding acceptance.

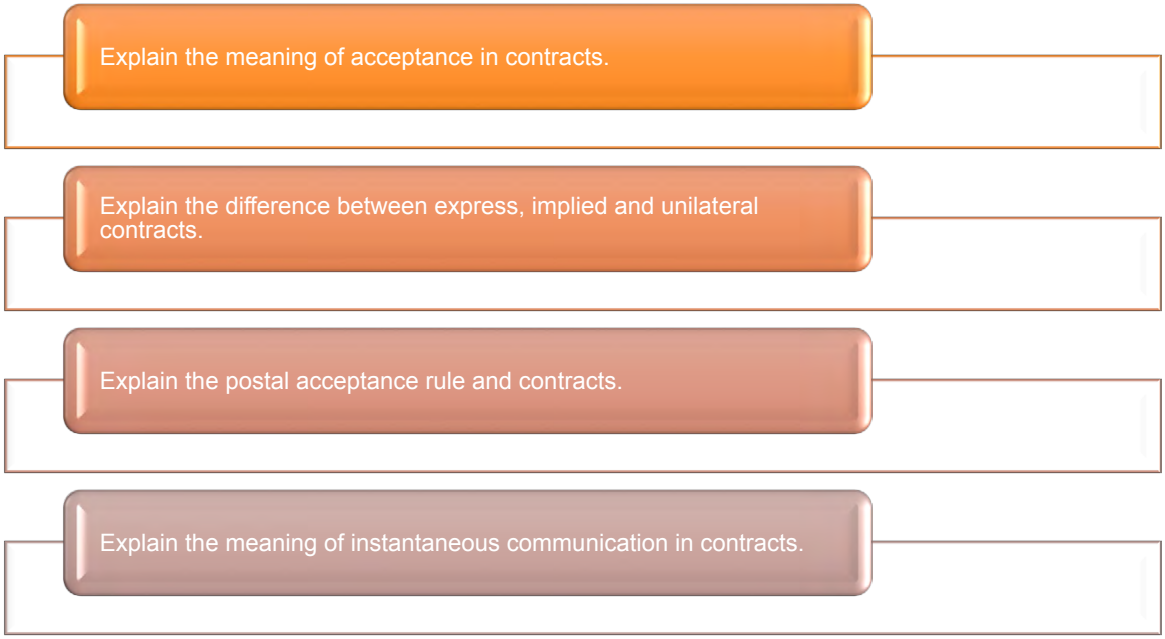
MO4: **Describing the rules as to offer:** An offer is a clear expression of the terms under which a person is prepared to enter into a contract with another person and be bound by their acceptance on those terms. The main rules relating to an offer are: An offer must be communicated to the Offeree. This can be in writing, orally or by conduct; An offer can be made to a particular person, a group of people or to the whole world; An offer can be revoked at any time before acceptance unless it is in the form of an option; and an offer can be terminated by rejection, counter-offer, lapse of time, failure of a condition or death of a party if the contract is one of personal service.

MO5: **Explaining the difference between an offer and an invitation to treat:** An invitation to treat is not an offer, but rather is an offer to consider offers. This is because the person making the statement does not intend their words or conduct to constitute an offer – for example, as in the case of advertisements. An invitation to treat cannot be accepted and can never give rise to a contract. An offer is a clear expression of the terms under which a person is prepared to enter into a contract with another person and be bound by their acceptance on those terms. In the case of an offer, the person making the offer does intend to be bound by the offer. The distinction is important because acceptance of an offer brings a contract into existence.

Module 10 The Acceptance

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Acceptance: is an agreement or asset, consent to receive something that is offered. In contract law full acceptance by one party, without qualification of an offer made by the other party creates a binding contract.

Offeree: the one to whom an offer made.

Offeror: the one who makes the offer.

Key Cases

Adams v Lindsell (1818) 106 ER 250
Carlill v Carbolic Smoke Ball Co [1893] 1 QB 256
Entores Ltd v Myles Far East Corp [1955] 2 QB 256
Felthouse v Bindley (1862) 11 CBNS 869
Manchester Diocesan Council of Education v Commercial and General Investments Ltd [1969] 3 All ER 1593

Masters v Cameron (1954) 91 CLR 353
R v Clarke (1927) 40 CLR 227

The Acceptance

The agreement in respect to the second element of a contract occurs once acceptance of the offer has taken place. An acceptance of the offer is the final consensus between the parties to the terms that were made in the actual offer. The actual acceptance of an offer can be made orally, in writing and sometimes by implication from the conduct of the offeree which may arise from past or prior dealings. Once an acceptance to an offer on the specified terms has been made any cross-offers that are made will not give rise to a contract as in this instance there is no acceptance to something that has not been agreed to by the parties. Acceptance therefore is an acknowledgment by the person to whom the offer was made that the offer is accepted and it must comply with the terms of the offer and must be communicated.

Acceptance is the moment of contract and it determines when a contract comes into being. In some cases it may also be necessary to determine where a contract comes into being and the actual place of acceptance may establish this in the circumstances. Just as with offer, the courts have over the years devoted some attention to the crucial step of acceptance, and it is the difference between contract and no contract. In doing so, the courts have developed some precise rules which reflect the assumptions underlying offer and acceptance which is based on an objective test by the courts in examining the individual circumstances and conduct between the parties.

10.1 Rules of Acceptance

The acceptance to an offer can take place in a number of ways such as:

- Express words or in writing (bilateral contract involving an exchange of a promise for a promise);
- By conduct (express or implied) as is illustrated by *Clarke v Dunraven* [1897] AC 59; and
- Performance of an act (unilateral contracts).

It should be noted that acceptance cannot take place by silence or by pleading ignorance of the offer. Generally, an offer can only be accepted by those persons to whom the offer was made. However as a result of this general rule, there are a number of other specific rules with respect to who can accept an offer and include:

- Acceptance cannot occur unless and until the offeree has received the offer, and this is because the offeree must be actually aware of the existence and terms of the actual offer before it can be accepted or even agreed to between the parties.
- An act that is done in ignorance of an offer does not constitute acceptance.
- The offer must be present in the mind of the 'acceptor' when the 'acceptance' actually occurs otherwise there is no real and true acceptance of the offer.
- Provided that the offer is in the mind of the 'acceptor' at the time of acceptance, motive is not a material consideration.

ACCEPTANCE

- The acceptance must relate to the actual offer: See *R v Clarke* (1927) 40 CLR 227
- Acceptance must be communicated to the Offeror as silence does not constitute acceptance: See *Felthouse v Bindley* (1862) 11 CBNS 869
- Acceptance must be unqualified: See *Masters v Cameron* (1954) 91 CLR 353
- Acceptance must conform with the Offeror's requirements.
- The method of acceptance must be appropriate.
- If the acceptance is posted then the acceptance is deemed effective at the time of posting: See *Adams v Lindsell* (1818) 106 ER 250
- Acceptance by means of instantaneous communication must actually be received to be effective: See *Entores Ltd v Myles Far East Corp* [1955] 2 QB 327.
- Any acceptance to an offer by an agent may only be effective and valid if that agent was actually authorised to act on behalf of the Principal.
- Communication can be waived if made to the world at large: See *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256

In accordance with this general rule as to acceptance of an offer, it is evident that there are only very limited situations in which a person other than the offeree will be able to accept the offer. In this exceptional situations, the only reason that this can arise, is where the actual intention of the offeror was that someone outside the ambit of the purported agreement might accept the offer that was being made and it was intended that this exception arises in the particular circumstances.

The simple rule regarding acceptance is that if there is to be a real and genuine agreement, the acceptance to the offer:

- must be made in reliance of the offer;
- must be strictly in accordance with the terms of the offer;
- must be communicated to the offeror orally, in writing or by conduct;
- cannot be a cross-offer;
- can only be accepted by the party to whom the offer was made;
- must be absolute and unqualified; and
- once made, cannot be revoked without assent of the offeror.

10.2 Reliance and Acceptance

An offeree must actually respond to an offer and they must know about it and have relied on the offer. Also it is essential that the offer must be 'in their mind' at the actual time of acceptance in order for the acceptance to be real and genuine. This simply means that the offeree must intend to accept the offer otherwise there can be no agreement between the parties and the actual reasons for motives of the offeree in making the offer is irrelevant.

10.3 Terms and Acceptance

If the offeror specifies and states a special or specific method of acceptance in the terms of the offer then that method or acceptance must be strictly followed in order constitute acceptance. If there is no particular methods stated as to the manner of acceptance of the terms of the offer, then the rule applied here in respect to acceptance, is that of the custom of the trade or what is reasonable in the particular circumstances as constituting and giving rise to a good and valid acceptance to an offer. For instance, an offer sent by email or fax purports some element of urgency requiring a prompt reply, so any manner of fast or faster acceptance to the offer will be effective and acceptable in such circumstances.

10.4 Communication of Acceptance

As a matter of common sense, acceptance must be communicated either by express words or implied by conduct. This means that 'silence' cannot be taken to mean acceptance and a 'mere mental resolve' that is an intention to accept an offer, is insufficient unless it is followed up by actual communication either expressed or implied. An offeror cannot make silence a valid method of acceptance, and accordingly if the offeree does not say anything then there is no objective way of knowing whether the offer has been accepted or rejected. Actual communication therefore whether expressed or implied is vital and necessary otherwise how else is the offeror going to know if the offer has been accepted or not accepted.

Sometimes, this simple rule can, in appropriate circumstances, be displaced but only in exceptional circumstances. For example, the reward type situations where it would be silly for everyone who is looking for a lost item such as a diamond ring to send a message that he or she has accepted. Also it would not be acceptance to *say* that you are looking for the lost diamond or other item for reward, as actually finding the diamond ring or other lost item for the rewards is the acceptance. In most situations where communication of acceptance is essential it is evident that failure to communicate will mean that there is no contract. The idea that communication of acceptance is generally essential has been applied very literally so that there is a supposed rule that silence cannot constitute acceptance. But this rule must be treated with some caution, as it essentially embodies an important basic notion about the institution of contract and that is the right of freedom *of* contract which should also include the idea of freedom *from* contract.

10.5 Absolute Acceptance

The acceptance to an offer must be absolute, unconditional and complete and this means that the parties in the negotiation to reach an agreement must have a *meeting of the minds.* If there are other matters to be negotiated before the agreement is finalised and fully accepted then acceptance is not complete. The actual acceptance to an offer is looked seen as being the final and unqualified assent or agreement (willingness to be bound) to the offer. Accordingly, the introduction of any new and different conditions to the initial offer that was made at this point in time will result in no actual acceptance having taken place and is deemed to be a counter offer or the reopening of further negotiations whose terms have to be accepted or rejected by the parties in the course of their negotiations and finally coming to an actual agreement when the offer as given and made is fully and completely accepted.

10.6 Postal Rule and Contracts

In this modern globalised world the use of the mail, telegram or the wide array of modern electronic communication to communicate acceptance to an offer being made gives rise to a number of problems, some of which cannot be easily resolved and common law rules have to be applied. However, the postal rule is an exception to the general principle that for an agreement to arise that acceptance to an offer must at all times be clearly communicated either by traditional form and medium the post or other means of specified communication by the Offeror.

The postal rule states that if acceptance by normal mail (the postal medium) is agreed to by the parties as the normal and traditional manner of accepting an offer, then that the actual acceptance to that offer takes place when the properly sent letter is posted and this acceptance by the postal medium is illustrated by the case of *Adams v Lindsell* (1818) 106 ER 250. Thus, at the time of posting the letter, the postal rule states that the contract comes into existence precisely at the time when the letter of acceptance is posted. Even if there is a delay in the delivery or if there is no delivery or even if the letter is lost. Additionally, in respect to need for the actual communication of the acceptance of the offer to the Offeror see also *Felthouse v Bindley* (1862) 11 CBNS 869; *Entores Ltd v Myles Far East Corp* [1955] 2 QB 327; *R v Clarke* (1927) 40 VLR 227 and *Masters v Cameron* (1954) 91 CLR 353.

This situation arises because by agreeing to the post as the main method of communicating, the person that has made the initial offer has in fact chosen the post office as the agent for the collection of any letters accepting an offer. Accordingly, under this rule any letter of acceptance when it is posted is deemed to have been actually handed over to the post office as agent, and the acceptance to the actual offer has been effected even if the letter has been delayed or is lost in the mail.

10.6.1 Exceptions to Postal Rule

The postal acceptance rule only applies to the actual acceptance of any offer that is made requiring some form of actual communication to its acceptance. This rule does not apply to a situation where an offer is made or where there is a revocation or withdrawal of an offer that is still to be communicated to the other party for negotiation and deciding whether to agree to the terms of the offer that was made. Apart from these exceptions there are a number of other limitations of exceptions to the postal acceptance rule such as:

- The postal rule does not apply if the offeror requires actual communication of acceptance, that is that the acceptance must be received either generally or within a specified period of time; and
- Instantaneous forms of communication, such as fax, email, telephone or SMS are not affected by the postal acceptance rule.

10.7 Requirement for Acceptance

Where the party making the offer states that a response must be received or is required to the offer within a definite period of time then the postal rule will be excluded and does not apply in this situation. It should be noted that the postal acceptance rule is only applicable where the post is a contemplated and agreed to means of acceptance to an offer. In this case, the defendant granted the plaintiffs an option to purchase certain real estate property. The option was "exercisable by notice in writing to the defendant but had to be made within six months from the date of the agreement". The plaintiffs sent a written notice within the prescribed time but it was never delivered. The plaintiffs then claimed for specific performance on the agreement. In its decision, the court held that the specific requirement for notice in writing to the defendant actually made the postal acceptance rule inapplicable. It also highlighted and reinforced the general principle that the postal acceptance rule only applies where the post is in fact a contemplated and agreed to means of acceptance.

10.8 Instantaneous Communications

In situations where parties negotiate by instantaneous communications, such as by telephone, either landline, mobile or SMS or by facsimile (fax) and email, agreement usually occurs when and where the offeror actually receives notification that their offer has been accepted. If for instance there are any delays or problems with the instantaneous communication that may delay or prevent clear communication, then actual acceptance of the offer does not take place until the acceptance is specifically repeated and clearly audible by the offeror. The *Electronic Transactions Acts* generally provide some basis for determining when instantaneous communication is actually sent and received. Unfortunately, there is no basis for determining the actual time at which a valid contract is formed. Consequently in respect to this form of acceptance to an offer, the general view is to apply both the postal rule and the receipt rule and the matter is still unresolved in this regard.

As a result of this indecision regarding the actual creation of the contract through instantaneous communication, the best approach is to initially apply the general rule. This general rule is that the party who receives the offer, the offeree must communicate the acceptance back to the offeror, by treating email and the internet as not invoking the postal acceptance rule unless the intention of the parties are made clear during the initial negotiations that consequently lead to the actual formation of the contract by the acceptance of the offer being clearly communicated. See the cases of *Entores Ltd v Myles Far East Corp* [1955] 2 QB 327 and *Felthouse v Bindley* (1862) 11 CBNS 869 in respect to the importance of communication of the acceptance to the offer.

Key Points

The key points in this module are:

MO1: Explaining the meaning acceptance: This refers to an unqualified acceptance to an original offer by the Offeree to the Offeror.

MO2: Explaining the difference between express, implied and unilateral contracts: An express contract is one that is created by words (oral) written or both; an implied contract is one entered into by prior conduct or prior dealings, and a unilateral contract is one in which only one party has to perform his or her promise under the contract.

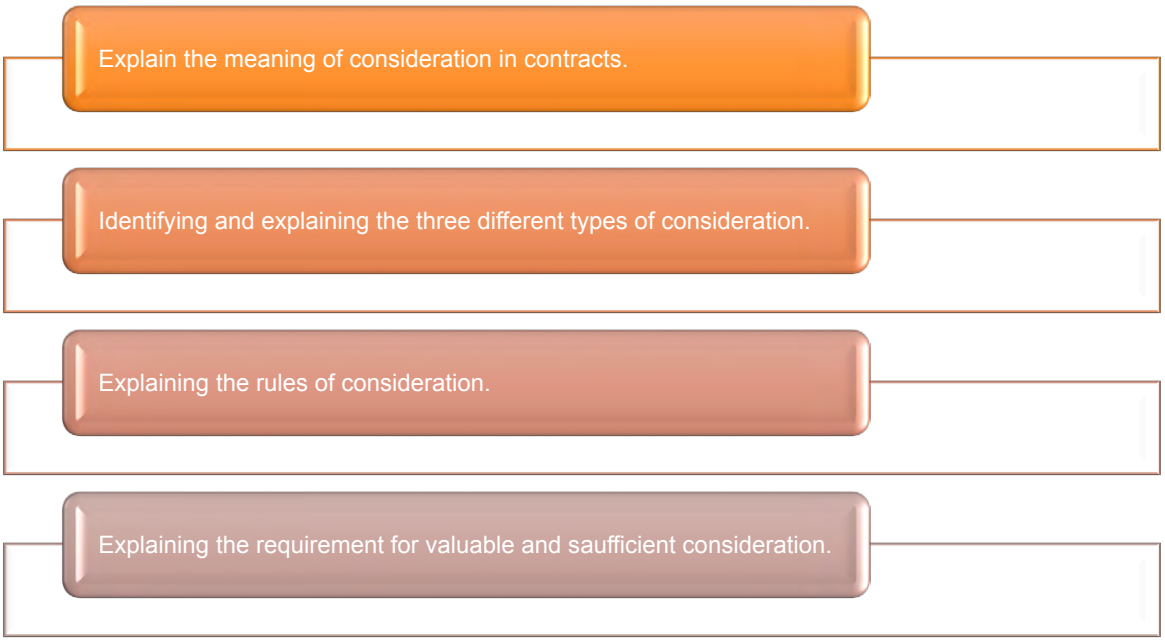
MO3: Explaining the postal acceptance rule: Where the parties contemplate the use of the post as a mode of delivery in respect to the acceptance of an offer where no other medium of acceptance has been specified for acceptance – that is, acceptance of the offer is effective when it is posted.

MO4: Meaning of Instantaneous Communications: When communication is instantaneous (telephone, teleprinter or fax) the postal rule does not apply and the contract is formed when the acceptance is received by the Offeror. That problem associated with the postal acceptance rule such as lost mail, does not exist where instantaneous methods of communication are used.

Module 11 Consideration

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Consideration: the price paid to buy the other person's promise and must be in every simple contract for its validity and enforceability of promises.

Deed: is a written instrument that has been signed, sealed and delivered, and which does not require the presence of consideration for its validity.

Formal Contract: is a contract that has been signed, sealed and delivered, and which does not require Consideration to be present, such as a Deed.

Promisee: refers to the person who is receiving, or the recipient of, the promise.

Promisor: refers to the person undertaking the promise.

Simple Contract: is a contract that is not special like formal contracts, and requires sufficient consideration for it to be valid, unlike contracts that are described as 'formal' or 'under seal'.

Key Cases

Couldrey v Bartrum (1881) 19 CH 394
Coulls v Bagot's Executor and Trustee Co Ltd (1967) 119 CLR 460
Dunlop Pneumatic Tye Co Ltd v Selfridges [1915]
Eastwood v Kenyon (1840) 11 AD & E1 348
Foakes v Beer (1884) 9 App Cas 605
Glasbrook Bros Ltd v Glamorgan County Council [*1925*] *AC 270*
Hartley v Ponsonby (1857) 7E & B 872
Pinnel's Case (1602) 77 ER 23
Rann v Hughes (1778) 7 Term Rep 350; (1778) 101ER 1014
Roscorla v Thomas (1842) 2 QB 851
Stilck v Myrick (1809) 2 Camp 317
Thomas v Thomas (1842) 2 QB 851
White v Bluett (1853) 23 LJ Ex 36
Wigan v Edwards (1973) ALR 497

Consideration

After offer, acceptance and intention to create legal relations, the other essential element that is required for the creation of a contract is consideration. Consideration is an aspect of the concept of 'mutual' promises that forms the basis of the law of contract. In essence consideration is the bargained-for exchange, that is, it is what each contracting party actually bargains with and gives to the other party in exchange for the return promise or performance of the other party. Fundamentally, it is the legal benefit received by one person and the legal detriment imposed on the other person. Consideration usually takes the form of money, property or services. Thus, persons wishing their promises to be enforced must show that the promises were in fact supported by consideration. Consideration usually consists of payment of money, but sometimes it can also be performing or doing something or refraining or promising not to do something.

Essentially, to support the contract, consideration is something that has been given in return for the promise of the promisor, and it simple terms 'consideration is something for something'. If there is no consideration then an agreement will only be enforceable if it is in the form of a deed which are usually used to ensure that contracts not supported by consideration are enforceable. Thus, for an agreement to be regarded as a contract, it must be supported by consideration, which is the third essential element that is required to form a valid contract or it must be a formal contract.

11.1 Meaning of Consideration

Consideration is something of value, and need *not be commercially adequate* to the promise, that is given or promised by the party seeking to enforce the contract and it is usually an essential element in the formation of a valid contract. Consequently, the parties are free to make their own bargains and the court will not intervene or inquire into the commercial viability of adequacy of the consideration that was given as was seen in *Thomas v Thomas* (1842) 2 QB 851. Consideration is essential in most all agreements with exception in respect to formal contract (deeds), and in its simplest meaning is *'something of value that is given by the parties to each other under their agreement.* Similarly, consideration *must not be too vague or indefinite* as is illustrated by the case of *White v Bluett* (1853) 23 LJ Ex 36 and must be sufficient as was seen in *Eastwood v Kenyon* (1840) 11 AD & E1 348 and *Wigan v Edwards* (1973) ALR 497. Essentially consideration is the price or value of the promise for which the common law requires that *a price is to be paid for every person's promise before the promise will be enforced at law.*

Consideration therefore is regarded as something that is done or promised to be done by one party in exchange for something to be done or promised to be done by the other party. In this context mutual promises are the fundamental basis of consideration, which is generally described as an exchange for value for value. Traditionally, the law required that the parties to an agreement must supply, bring or provide something that has some real value to each of the parties. Hence this approach to requiring some form or valuable consideration gave rise to the notion of their existing a bargain between the parties based on mutual promises. When both parties give or provide such promises at the time that the agreement is being entered into that leads to the contract then the promises have some value and are deemed to constitute the third essential element, consideration that supports the simple contract.

Accordingly, these respective promises made between the parties to the consideration actually support the agreement and in turn create or give rise to a legal and binding contract that is enforceable at law. In respect to consideration it is essential that there is valuable consideration to support the promises made by both parties and depending on the form or nature of the consideration and the types or classifications of consideration and hence the promises made and the types or classifications of consideration will depend on the nature of the remedies available to an innocent party in the event of a breach of the promise made and where no valuable consideration has been given or provided as promised during the course of the pre-contractual negotiation. In respect to consideration and the different types of contracts see Figure 11.1 Types of Contracts

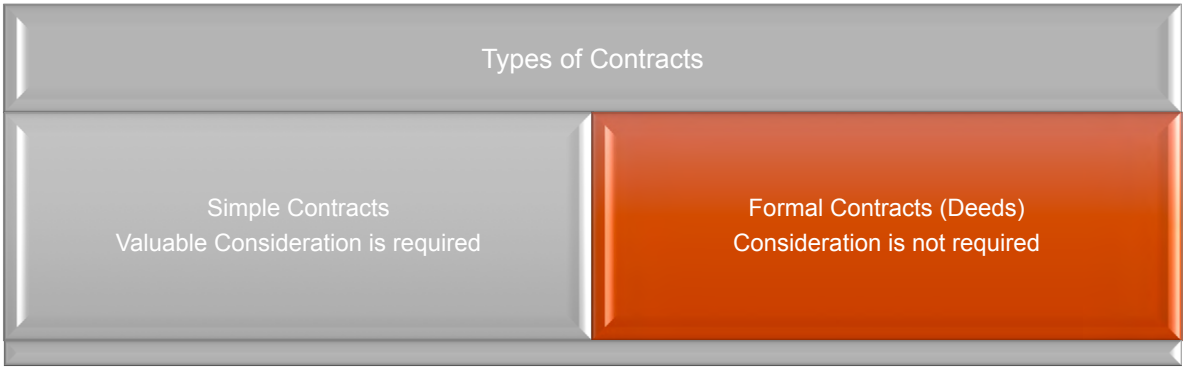


Figure 11.1 Types of Contracts

11.2 Parties to the Consideration

The terms 'promisor' and 'promisee' are generally used in order to described the actual parties to a contract in which consideration is present and required in order for it to be legally valid, binding and enforceable. The promisor is the person who agrees to perform the actual 'consideration' that is the doing of the thing or conduct or promise and the promisee is the party who receives the consideration as promised under the agreement and this bargain or promises made between the parties is illustrated by Figure 11.2 Parties to Consideration.

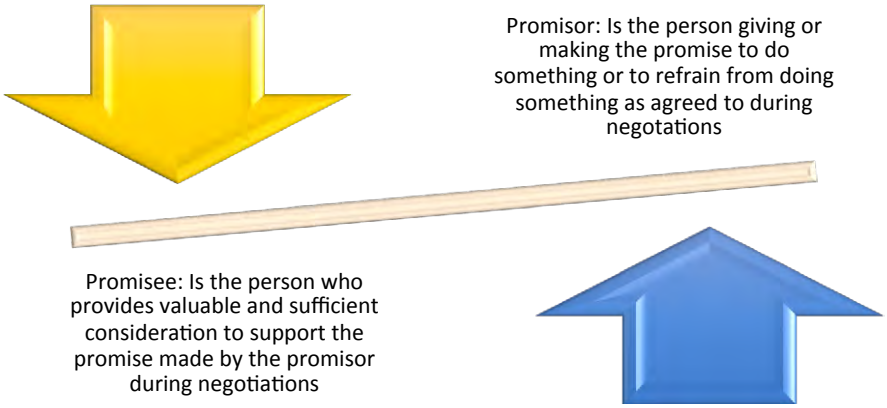


Figure 11.2 Parties to Consideration

11.3 Forms of Consideration

Consideration that is valuable consideration can take many forms including:

- An act for an act;
- An act for a promise;
- A promise for a promise; and
- A promise for an act

Generally all contracts require valuable and good consideration that can be enforceable in the courts. However in some instances consideration is not required especially in cases of formal contracts such as courts of record and contracts under seal that take their legality form their form alone, that is in the manner that they are expressed or written as prescribed by law.

11.4 Classification of Consideration

There are a number of different types of consideration. Consideration is generally classified as either 'executory' or 'executed'. Consideration that is yet to be actually carried out and performed by the promisor is described as executory while the consideration that has already been performed and carried out is described as being executed. In this context, see Figure 11.3 which illustrates the different types or classifications of consideration under contract law.

If there are any promises that are not supported by any form of valuable consideration they are referred to as gratuitous promises. They are generally in the forms of gifts and not enforceable at law unless they are in a particular prescribed and legal form such as a deed or court records. In essence, there are three main types of consideration, an act for a promise; a promise for a promise and forbearance and are discussed as follows:

- **An act for a promise** – present consideration (executed consideration); and
  - This type of consideration is referred to as present or executed consideration because it take place immediately as soon as one of the parties has carried out, that is actually performed (executed) their particular promise made to the other party.

- **A promise for a promise** – future consideration (executory consideration);
  - Each party promises to do something of value for the other at a later date and they both providing future or executory consideration, and if all the element of a valid contract are present, the parties can enter a contract and are legally bound immediately upon the exchange of the promises made between the parties.

- **Forbearance** – a promise not to enforce a legal right.
  - A promise, that is the person to whom the promise has been made, can also provide consideration by forbearance, by promising not do to something that they have a legal right to do, and whether the consideration is present or future is dependent on each particular circumstances surrounding the promise that was made between the parties.

Figure 11.3 Types or Classifications of Consideration.

11.5 Consideration and Types of Contracts

If a contract is written in a particular and prescribed form than there is no need for any form of consideration, and are referred to as formal contracts such as a deed and contracts of record. Formal contracts at law do not require any consideration and they are mainly of two forms such as contracts of record and contracts under seal that is deeds. A judgement of a court is an example of a contract of record. All formal contracts are deemed to be contracts under seal and must be expressed or written down for them to be legally valid and enforceable.

However, a deed which is a formal written contract does not require consideration as it takes it validity from its particular form or manner in which it is expressed or written. On the other hand, simple contracts that are not under seal nor contracts of record do require some form of valuable consideration which must be provided by the person to whom the promise is made as is illustrated by *Dunlop Pneumatic Tye Co Ltd v Selfridges* [1915]. However, if a promise is made to two parties and only of them actually provides the consideration then the contact can be enforced by both as illustrated by *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460.

Simple contracts may take any form and can be verbal, written or implied, but they must have valuable consideration for it to be valid as is illustrated by the case of *Rann v Hughes (1778) 7 Term Rep 350; (1778) 101ER 1014*. In respect to distinguishing between formal and simple contracts, it is essential to state that in simple contracts there must be present some form of valuable consideration. In this regard consideration must be present, future but not past in support of a valid and legally enforceable simple contract.

11.6 Types of Consideration

There are different types of consideration that must be present to ensure the validity of a contract by the presence of valuable and sufficient consideration to support the promises made between the parties to a contract. These different types are as follows:

- **Present (executed) consideration** – present (executed) consideration exists where the promise or act that is consideration is performed when the contract is made. In this situation the consideration is given as part of the same transaction as the promise.
- **Future or executory consideration** – future (executory) consideration exists where the act that in the consideration is to be performed at a time after the contract is made. This simply means that the parties to a contract both promise to exchange something of value in the future, such as, for example, the payment of the price (hence the consideration) upon delivery of goods purchased from a supplier. In this situation the supplier of the goods purchased promises to deliver the goods at a particular time and place upon payment for the goods by the purchaser. Accordingly, provided that all the other elements that constitute a valid and legally enforceable contract are present and satisfied, the contract is then formed at the time that the promises are actually made and performed by both parties.
- **Past (or insufficient) consideration** – past (or insufficient) consideration exists where the act is the consideration was performed before the contract was made. Generally, it is not possible to rely on act or promise that has already been performed. It is not usually appropriate to create new rights and obligations for matters that have occurred in the past. There is an exception to the past consideration rule not being adequate consideration if it is actually linked to the initial promise. However, as a general rule when a promise is made after an act has been performed past or bad consideration has taken place. Past (or bad) consideration is therefore, not enforceable under contract law, due to insufficient consideration.

11.7 Rules of Consideration

Consideration is essential to every simple contract. As a result of the requirement at common law for the existence of consideration in a contract, the courts have dealt with many legal contractual disputes and issues regarding the element of consideration, its meaning, and form and when it is actually necessary to enable a contract to be legally enforceable.

Accordingly over the years as a result of decided cases, certain rules regarding consideration have been developed and they are as follows:

- valuable consideration must be supplied by the plaintiff but need not be adequate;
- the nature of the consideration must be definite, not vague;
- consideration is not permitted to be so vague that not is illusory;
- consideration must be capable and possible of being performed;
- consideration must be sufficient;
- consideration must not be illegal or unlawful; and
- consideration must be more than a person is already obliged to do.

11.7.1 Valuable Consideration

A party seeking to enforce obligations or promises that have been made under an agreement between another party must be able to show that they had supplied value that is consideration in exchange for that particular obligation of promise from the other party to the agreement. Consideration must have some legal value and involve a detriment and a benefit, but is does not have to be adequate.

11.7.2 Sufficient Consideration

Consideration must have some legal values but it does not have to be adequate. In this context consideration is recognised as being sufficient if it is provided 'valuable' as between the parties that are involved in the contract. Courts are not generally concerned with whether or not the deal as such is good or bad between the parties or whether the bargain is unequal and are also not concerned with establishing if the bargain was fair as this is something left to the parties to determine among themselves at the time of the initial negotiation.

Thus, provided that there has been a bargain made between the parties and that something of value has been transferred or changed hands then the law will not usually interfere were the consideration is seen to be trivial, nominal or less than market value. The question or issue of adequacy of the consideration is not a concern for the courts otherwise it would involve all commercial and economic contracts being examine to ascertain if the price was reasonable and this would be an impossible task. The courts then take the view that unless there is insufficient consideration, they will not interfere in any contract where the actual agreement and subsequently the contract is supported by some form of valuable consideration which has been agreed to between the parties.

11.7.3 Definite Consideration

The consideration that is given in each agreement to create the valid contract must be real, certain and actually identifiable. In other words it must be definite and it cannot be too vague or indefinite in nature.

11.7.4 Lawful Consideration

Consideration must be lawful and cannot be illegal. If there are any promises or conduct that is in breach of any common law or statute law they will not be identified as consideration in order to support a contract. Where consideration is used for illegal acts or in breach of criminal or civil law, there will be no consideration. In respect to consideration being lawful it must also be definite and clear and the actual nature of the consideration must be 'transparent and clear as well as coherent identifiable and legal. This means that where the consideration is illegal, constitutes a breach of public policy or the civil law, then there will be no consideration.

11.7.5 Performance of Consideration

If the promise of one of the parties cannot be physically impossible to be performed then there it is deemed that there is no real consideration to support the promises that were made between the parties. Consideration must be capable of being performed and a promise to perform what is clearly an impossible act under the contract is deemed to be not good consideration.

11.7.6 Valuable Consideration

The law of contract is fundamentally based on the idea and notion of a bargain. Consideration highlights the essential requirement of a commercial or economic element that must be supported by consideration otherwise the simple contract will have no validity and will be deemed to be *void ab initio* (void from the beginning). In respect to the requirement for the element of consideration the general and accepted rule is that a simple contract does not have any validity and is in fact *void ab initio* without the presence or existence of the element of consideration. In respect to this requirement for consideration and the necessity for its existence, is that unless each party to the purported contract actually provides some form of valuable consideration to support the simple contract than there is just an agreement and no contract has been entered into as between the parties.

In simple terms, the law is reluctant to recognise any contract between parties when it is not supported by any valuable consideration and will merely treat them in this instance as gratuitous promises that is the promise of gifts as there is no legal obligation, but merely an oral obligation in these situations once the agreed conduct or promise is actually carried through and performed. However, the actual requirement and necessity for consideration is an essential part of contract law and its strict compliance is necessary in order to a make an agreement enforceable in a court of law.

In some contractual situations, the requirement for actual valuable consideration if applied too strictly, will make an agreement unenforceable or can often lead to unfair and unconscionable conduct or outcomes in a commercial transaction. As a result of some severe and harsh outcomes if the strict compliance for valuable consideration is enforced by the courts has given rise to major exceptions to the rule for the existence of valuable consideration in order to alleviate any harshness and eliminate any absurdities.

Both in equity law and under statute law the major exceptions to this rule for consideration are as follows:

- The development of the equitable doctrine of promissory estoppel where courts may enforce a promise even when there is no consideration present; and
- Some legislation in various jurisdiction, allows for legal action to be taken for misleading and or deceptive conduct, false representations, and unconscionable conduct in some situations where consideration exists as well as where it is not present.

Key Points

The key points in this module are:

MO1: **Explaining the meaning consideration:** Is the price paid for a promise in a contract, which can consist of a right, interest, profit, or benefit accruing to one party or some forbearance (patience), detriment, loss, or responsibility given suffered or undertaken by the other party to the promise.

MO2: **Identifying and explain present (executed) consideration:** present (that is, executed) consideration occurs when an immediate and present act is done in return for a promise, such as arises in situations of buying goods in stores and attaining immediate possession.

MO3: **Explaining the rules of consideration:** there are a number of rules of consideration and the main one is that consideration is essential to the validity of all simple contracts. Other rules of consideration are: that consideration must be present and not past; it must have some value and be sufficient; it must be possible of performance, it must be definite, it must be legal and must be referable to the other party's promise.

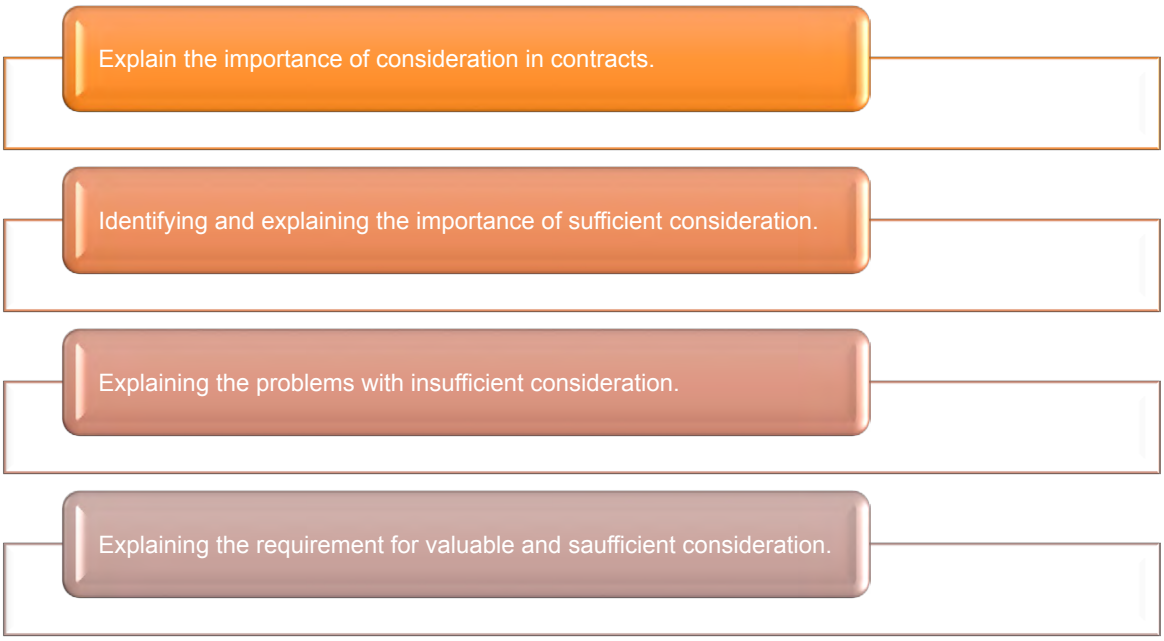
MO4: **Explaining the difference between the different types of consideration: past, present and future:** past consideration is given after an act has been performed and is generally not enforceable; present (executed) consideration is where an act is done in return for a promise; and future (executory) consideration arises where the parties exchange promises and each promise being consideration for the other promise.

MO5: **Explaining the need for valuable (sufficient) consideration:** one of the main rules for consideration is that there is a need for valuable and sufficient consideration to cement the promises made between the parties but the court is not concerned as to its adequacy.

Module 12 Operation of Consideration

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Promisee: refers to the person who is receiving, or the recipient of, the promise.

Promisor: refers to the person undertaking the promise.

Valuable consideration: Consideration must have some value, although the court is not concerned with its adequacy.

Key Cases

Couldrey v Bartrum (1881) 19 CH 394
Coulls v Bagot's Executor and Trustee Co Ltd (1967) 119 CLR 460
Dunlop Pneumatic Tye Co Ltd v Selfridges [1915]

Eastwood v Kenyon (1840) 11 AD & E1 348
Foakes v Beer (1884) 9 App Cas 605
Glasbrook Bros Ltd v Glamorgan County Council [*1925*] *AC 270*
Goldsborough Mort & Co Ltd v Quinn (1910) 1 QB 674.
Hartley v Ponsonby (1857) 7E & B 872
Pinnel's case (1602) 77 ER 23
Rann v Hughes (1778) 7 Term Rep 350; (1778) 101ER 1014
Roscorla v Thomas (1842) 2 QB 851
Stilck v Myrick (1809) 2 Camp 317
Thomas v Thomas (1842) 2 QB 851
White v Bluett (1853) 23 LJ Ex 36
Wigan v Edwards (1973) ALR 497

Operation of Consideration

An agreement will generally not be enforced unless the Promisee has given consideration for the promise as is illustrated by a number of cases such as *Dunlop Pneumatic Tye Co Ltd v Selfridges* [1915] and *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) 119 CLR 460. Consideration is something of value that is given or promised in return for the other party's promise. An exception to the consideration rule is in the case of a promise that is made by a deed which is a formal contract. A deed essentially binds the person who signs it to everything written in the deed which by its very nature or form does not require any consideration to be make it legally enforceable for this kind of promise as the deed itself is sufficient consideration.

Consideration does not have to be in the form of money. It can consist of any work done in return for wages or salary, a promise to release a person from paying some money owed to you in return for a week's free holiday with you in the borrower's holiday home on the coast; or even a gift of a iPod or iPhone in return for a copy of the downloaded music. These are mere examples but they help to illustrate the fact that the court does not concern itself with what is promised, actually given or given up, but only with the fact that something was actually 'bought' the promise.

12.1 Importance of Consideration

The classic definition of consideration is: 'A valuable consideration in the eyes of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other'. Simply put, the element of consideration is about exchange of promises. It is the price paid for the promise and it can be either in for form of some benefit that is conferred on the promisor by the promise or some detriment or loss suffered by the promisee. Such an example of how consideration is applied and works in the commercial world is that of a bilateral contract. In some instances consideration may consist of a promise to settle a disputed legal action and avoid legal proceedings. In respect to the situation where a claim has been settled the courts have held that a promise to withhold legal action may be consideration where there is a reasonable claim, a genuine dispute or there a reasonable prospects for successful legal action.

Consideration is the price you pay to buy the other person's promise and it is this concept of 'price paid' or an "*act or forbearance of one party, or the promise thereof, is the price for which the promise is bought; and the promise thus given for value is enforceable*". In simple terms, consideration is something of value that is given by both parties to one another under the agreement that they have negotiated and agreed upon by forming the contract that makes their agreement legally binding and enforceable. Consideration which is the third essential element in an apparent simple contract can take a number of forms including, an act for an act; an act for a promise; a promise for a promise; and a promise for an act.

Most simple contracts which form the majority of the contracts entered into a daily and regular basis require some form of valuable consideration in order for the promise to be enforceable in the courts but it is not necessary in all contracts such as formal contracts. Formal contracts do not require consideration because these types of contracts such as deeds and courts of records that take their validity from the way that they are specifically formed or constructed.

12.2 Aspects of Consideration

Consideration is something of value given or promised by the party seeking to enforce the contract. Consideration may consist of a material item or the doing of some task, or a promise to do something or it may be a negative act, such as to refrain from doing something under the promise. Consideration is essential for the enforceability of contracts that are not under seal (formal contracts) and it is the bargain element in a contract.

The protection of the law is not afforded or provided to gratuitous promises (gifts) as they are generally not supported by any form of valuable consideration and generally are based on promises that the courts will not interfere with or involve itself such as a father promising to pay his son $1,000 if he passes his final examinations in business law and then he does not pay will not be enforced in a court as it is only a moral obligation and has no legal obligation attached to that promise.

In practical terms and in its operation to assist parties in supporting promises, consideration may be of three kinds as listed below and illustrated Figure 12.1 Different Types of Consideration:

- executory (future consideration) that is a promise to do or give something; and
- executed (present consideration) that is actually doing or giving something
- past consideration (cannot support a valid contract): *Roscorla v Thomas* (1842) 2 QB 851.

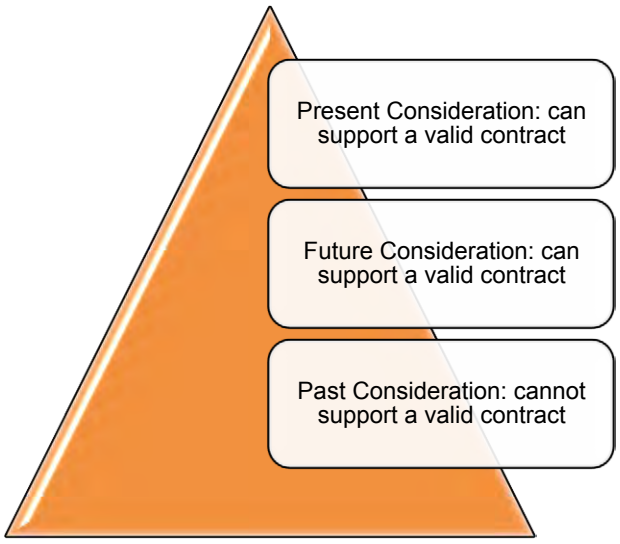


Figure 12.1 Different Types of Consideration.

Apart from a few exceptions, consideration must not be past. Past consideration means that consideration which does not actually for part of the initial bargain element but which is performed independently of what is usually promised under the contract. It should be noted that there are a number of practical exceptions to the rule that consideration must not be past and which allows for past consideration to be sufficient in order to support the contract for commercial viability and arises:

- Where something was done at the request of the defendant and the parties usually have assumed that payment will be made.
- Where creditors may sue following:
  - Acknowledge of a statute-barred debts: where a creditor is unable to recover a debt because of the *Statue of Limitations*, of the relevant jurisdiction of a later promise by the debtor to settle the best id legally binding and enforceable; and
  - The giving of a bill of exchange.

12.3 Consideration at Common Law

At common law if a party wishes to enforce an agreement he must provide consideration for it and usually both parties provide consideration and may enforce the agreement, but it is possible that only one party may provide consideration and be able to enforce the agreement while the party who provides no consideration cannot enforce the agreement. In some situations a promise that is made by one party to two other parties jointly, only one of those parties may provide the consideration to support the promise. This means that in some situations the courts allow that a party or parties that do not provide consideration can actually enforce the promise that was made, and this arises because in some circumstances contracts may indirectly confer legal rights and obligations to a party or parties who have not supplied or provided any consideration.

The types of contracts that usually give rise to this situation which generally also involve exceptions to the privity of contract rule are in respect to life insurance contracts and negotiable instruments such as money orders, cheques, bills of exchange, bills of lading and promissory notes. There is also a definite comparison with the above situation to situations where a promise is made by one party to the other party in order to provide some benefit to a person who is not a party to the promise. At common law that person was historically unable to enforce the contract in his or her own name as he had not provided any form of consideration to support the promise and hence the contract.

12.4 Consideration and Promisee

In order for consideration to be valid and actually enforce the promise made between the promisor and the promisee, it is crucial that the consideration actually moves from the party who is to receive the promise that is the promise. If for example, no consideration is provided, then no valid contract will exist and the promise will be unenforceable in a court. Accordingly, it is in this context that consideration is deemed to consist of both a detriment, in respect to the party who is providing the actual consideration and an actual benefit for the party who is to receive the benefit. It is not necessary, however, for the promise to receive the benefit, as all that is required is that the promisee has in fact provided consideration at the request of the promisor, regardless of whether or not the consideration was actually receive by the promise.

In respect to illustrating how consideration works the following are good examples: *A decides to paint B's house if B pays A $8,000.* This is an example of a bilateral contract as it consists of two parties that is two promisors and two promises. The sum of $8,000 constitutes good consideration for the promise by B to pay for the promise as it moves from A. The proposition that consideration must move from the promise does not always means that the consideration must move to the promisor. This is because in some cases, the promisor may stipulate as consideration that the promise provide some benefit to a third party, for example, "*A promises to pay B $8,000 if B paints C's house*" and constitutes a promise for value that can be enforced by A.

12.5 Forbearances and Consideration

Consideration can take the form of an *act* or a *promise*. Also, consideration can consist of an act of *forbearance* which is intentionally refraining from doing a particular act or thing, or exercising a particular legal right. In respect to business law, a particular example of forbearance as constituting valuable consideration is a *forbearance to sue*. This means that a party who is being sued or against whom legal proceedings have been taken or threatened may request that the legal action is not proceeded with, or withdrawn in exchange for example of a payment of a particular and specified sum of money in settlement of the claim or debt in dispute between the parties.

Historically, a plaintiff's forbearance preventing an honest claim from being proceeded with was held not to be good consideration if the courts had considered that the claim would have failed, but over the years for commercial viability, this rule has been modified by now allowing parties to come to a compromise in an honest manner and avoid costly litigation. Accordingly, today a plaintiff who is arguing a forbearance to sue as consideration for the defendant's promise must establish that in relation to the claim that has willingly been surrendered, that:-

- It was reasonable and not vexatious or frivolous.
- There was an honest belief in the chance of its success.
- No facts had been concealed from the other party, which might have affected the validity of the claim.

As a precautionary measure these restrictions are necessary in order to prevent any unscrupulous or absurd and unreasonable litigation actions against innocent parties, when the party has promised to sue or make other claims upon the performance of a promise, such as in a part-payment of a debt.

12.6 Consideration and Promises

Regardless of the type of consideration that exists in any particular case it must be given in exchange for the promise that was made between the parties. The concept of the 'bargain' is central to the law of contract and the rule that consideration must be given in exchange for the promise is integral to this concept. The promisor in these situations, in order to support the promise must expressly or impliedly request for some form of consideration, which is essentially the 'price' the promisor states or wants in exchange for the promise. In recent times the courts have made determinations that consideration will be found in any way possible in situations where it is reasonable to infer from the given facts that the parties to a commercial transaction actually intended to enter into a legally binding contract. This view of the courts is a best and practical approach for commercial reality and viability, and reflects the practical nature of the law of contract.

Essentially, the law of contract is determined wherever possible to support the view that generally all agreements intended by the parties to be of a legally binding and enforceable nature, for practical purposes should be upheld wherever possible. The main basis and underlying philosophy underpinning this practical concept of the law of contract is that the courts are committed to upholding, not destroying bargains and wherever possible will try to find the consideration that is needed to bind and make an apparent simple contract into a legally binding and enforceable contract.

12.7 Sufficiency of Consideration

Consideration does not need to be adequate to the actual promise that has been made. In the practical operation of consideration in the support of promise, the parties may decide for themselves whether the consideration is adequate for their particular purposes. Effectively, this means that the parties may basically agree to sell a property that is valued at $200,000 for only $2,000 without any court intervention. In respect to consideration and its practical operation, forbearance to sue is an illustration of how slight consideration may be and it should be noted in this context that a claim to a legal right and not the legal right itself is surrendered.

Also in its practical and realistic application in business and commerce transactions that eventually lead to the formation of contracts, the consideration that is provided must not be too vague or indefinite, and must be clear, concise, precise, easily recognised and unambiguous. To support a promise and hence the contract being negotiated, the consideration must be of some sufficient value in the eyes of the law, this means that is must have some value and it must be valuable consideration and not merely 'good consideration'.

The issue of the sufficiency of consideration is distinguished form the issue of adequacy and the general view is that if there is consideration present in the bargain being made and is does have some value as agreed to between the parties, then the courts will not be concerned with its adequacy. The question or issue of the adequacy of the consideration as opposed to its value is entirely left up to the parties to determine during the course of the negotiation of the agreement. However, the courts are concerned with the sufficiency of consideration to support the bargain, the promises made between the parties and hence the final contract.

As a consequence of this inherent need for there to exist sufficient and valuable consideration in contracts it often causes some difficulty because the question of what is sufficient and valuable as recognised by the law as consisting of good consideration is not always very defined or clear and can lead to confusion and uncertainly especially if the plaintiff is already under an existing legal duty and obligation to the defendant under the promises or agreement that was made between them. Therefore, the rule that consideration must be sufficient can cause practical problems where the plaintiff is already under a legal obligation to the defendant because generally if a person subsequently undertakes to do something that he is already obliged and legally bound to do so, the law attaches no value to this subsequent undertaking.

As a result there often arise in contractual situations a number of situations and instances which have been identified by the courts and the law as to what amounts or constitutes insufficient consideration. This aspect of the practical operation of consideration and which situations are deemed as constituting insufficient consideration is highlighted below:

- performance of a public duty imposed by law;
- performance of an existing contractual duty owed to the promissory is considered as being insufficient consideration as there is no detriment in repeating the existing duty owed to the promissory;
- performing an existing legal duty for a third party is good consideration and usually applied to cases involving exclusion or exemption clauses;
- promises to pay lesser amounts (part-payment of a debt) and this arises in situations where there is payment of a lesser sum in discharge of a debt when this occurs consideration is deemed to be insufficient.

12.8 Part-Payment of Debts

The practical problem with the requirement that consideration must be sufficient also arises where payment of part of a debt can be consideration for a promise to forgo the remainder of the debt. However, where the creditor agrees to something totally different to that to which he or she is entitled, such as the acceptance of a lesser amount paid on a date that is prior to the due date, the remaining debt in this instance, is said to be actually discharged by "accord and satisfaction". Payment of a lesser amount on the due date by cheque or another form of bill of exchange is not a discharge of the remaining amount of the debt as is illustrated by *Pinnel's case* (1602) 77 ER 23and *Foakes v Beer (1884)9 App Cas 605.* However, if the contract is varied as agreed to between the parties, such as for instance when the debtor pays earlier or pays with something other than money, the debt is deemd to be discharged by 'accord and satisfaction' as occurred in *Couldrey v Bartrum* (1881) 19 CH 394.

For this to occur, something different is required, such as a lesser amount has to be accepted one day before the debt is due in order for the remainder of the debt to be fully discharged. The issue of requiring valuable consideration and the problems associated with this, gave rise to the doctrine of promissory estoppel in order to minimise difficulties with this requirement for consideration in certain contractual situations and circumstances. The doctrine of estoppel, in simple terms means that a person who makes to another a representation as to existing facts intended to be acted upon, and which is in fact acted upon to the detriment of that other person will be prevented, that is stopped, from going back, or acting inconsistently with the representation.

12.9 Consideration and Public Duty

A promise to perform an act that one is already obliged to perform under some public duty is not recognised as good consideration as is illustrated by the cases of *Glasbrook Bros Ltd v Glamorgan County Council* [*1925*] *AC 270.* However, if the promise is to do something going beyond the obligations that are actually imposed by law, then the additional performance may amount to sufficient consideration.

12.10 Performance of Existing Obligation

A promisee's actual or promised performance of a pre-existing contractual duty does not constitute a good and sufficient consideration for the promisor's act, promise or forbearance. Irrespective of this, general rule in some exceptional circumstances such a promise may be regarded as constituting good consideration where it is seen as being beneficial as it confers a commercial benefit on the promise. It should be noted that similarly with promises to perform a public duty, is the promise in fact involves something more than is actually required under the previous contract, it will be treated as being insufficient consideration as is illustrated by *Stilck v Myrick* (1809) 2 Camp 317 and *Hartley v Ponsonby* (1857) 7E & B 872.

Key Points

The key points in this module are:

MO1: **Explaining the importance of consideration:** Consideration is one of the elements essential to prove the existence of a contract and is an important indicator that the parties intended to enter into a binding contract that is enforceable in a court of law.

MO2: **Identifying common law aspects of consideration:** Consideration is the price you pay to buy the other person's promise and is what the promisor gives in exchange for the return of the promise by the promise.

MO3: **Explaining the importance of sufficient consideration:** It needs to have some value and it need not be commercially adequate but it must be 'sufficient' in the eyes of the law.

MO4: **Explaining problems with insufficient consideration:** A promise to perform an existing contractual duty fails the test of sufficiency because the promise has already been made with sufficient consideration, and a further promise to perform the same task would lack sufficient additional payment. However, if something of additional sufficient value to the promisor is achieved by the Promisee promising to perform an existing contractual promise, the law may occasionally determine that there is sufficient consideration.

Module 13 Promissory Estoppel

Module Objectives

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

Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Promissory Estoppel: a form of estoppel founded on reliance. The basis of the doctrine is to hold a party who makes a promise to another accountable for detriment suffered by that other party in reliance on that promise, despite there being an absence of sufficient Consideration. It operates then there are issues of inequity or unconscionable conduct by one of the parties.

Key Cases

Central London Property Trust Ltd v High Trees House Ltd [1947] KB 130
Commonweatlh v Verwayen (1990) 95 ALR 321
Giumelli v Giumelli (1999) 190 CLR 101
Jorden v Money (1854) 5 HL Cas 185
Legione v Hateley (1983) 152 CLR 406
Walton Stores (Interstate) Ltd v Maher (1988) 164 CLR 387

Promissory Estoppel

The rule that consideration had to be present and provided in very simple contract in order for it to be valid has sometimes enabled a person to break an agreement and not be held accountable or legally at fault, even if the injured party has sustained a loss without any remedy available. Accordingly, the equitable doctrine (principle) of estoppel and promissory estoppel was developed in order to provide the injured party in such situations with a remedy in order to prevent serious loss or suffering as a consequence of the breach of the agreement by the defaulting party. In general terms a promisor who has entered into an agreement that lacks the essential element of consideration, may be stopped (estoppel/promissory estoppel) from unfairly breaking that promise if the other party suffers a significant loss as a result of reliance on the promise that was given by the party defaulting on their promise.

The essence of the doctrine of promissory estoppel is to ensure that a person should be held responsible to another person, if that person makes to the other a representation, normally under commercial situation that were intended to be acted upon and which is in fact acted upon to the other person's detriment such as economic and financial loss. Essentially, common law estoppel in its traditional form was in fact limited to and supported the doctrine of consideration, in respect to supporting representations that were made of existing or past facts and not of mere intention as is illustrated by *Jorden v Money* (1854) 5 HL Cas 185 and also *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130.

Therefore, this doctrine that evolved from common law out of the concern of English Judges "not to drastically erode that distinctive element of the English law of contract", that is the need for 'valuable consideration to support bargains', is fundamentally based on 'equity' and the idea of fairness. This means that it is considered unconscionable or extremely unfair if the promisor, who usually holds the dominant position in the agreement, is permitted to break the promise that was made to the promise, who may sustain significant economic or financial loss in reliance of the promise.

13.1 Basis of Promissory Estoppel

Historically, the courts of equity developed to soften the harsh consequences that had flowed from the rigid and inflexible application of common law rules. One such example is the development of the equitable doctrine of promissory estoppel. This rule was created in order to clarify the rule that a promisor is not generally bound to honour a promise for which consideration has not been paid, even though the promisor intended the promise to rely on it and the party did rely on it.

However, the effect of this rule was not commercially viable and caused a lot of inconvenience in practicability, because the rule fails to acknowledge and honour the view of the parties '*at the time the promise was made*' in respect to whether or not the consideration had sufficient value to support the promise that was made as between the parties. The importance of the doctrine of promissory estoppel is that it operates to enhance the actual effect and application of the rule in commerce to provide a form of remedy where the outcome may lead to an absurdity or unconscionable conduct if one of the parties tried to break a promise.

Thus as a result of the enhancement of the equitable doctrine of promissory estoppel nowadays in most common law jurisdictions, the courts will not allow a person, the promisor, to renege (or resile that is, to go back) on their representation or promise where it would be unconscionable, unjust or unfair to do so in the given situation. In fact promissory estoppel was developed from Equity and hence is often called 'equitable estoppel' and there are essentially five main elements or requirements that must be established for a satisfactory action in promissory estoppel and are illustrated by Table 13.1 Elements of Promissory Estoppel.

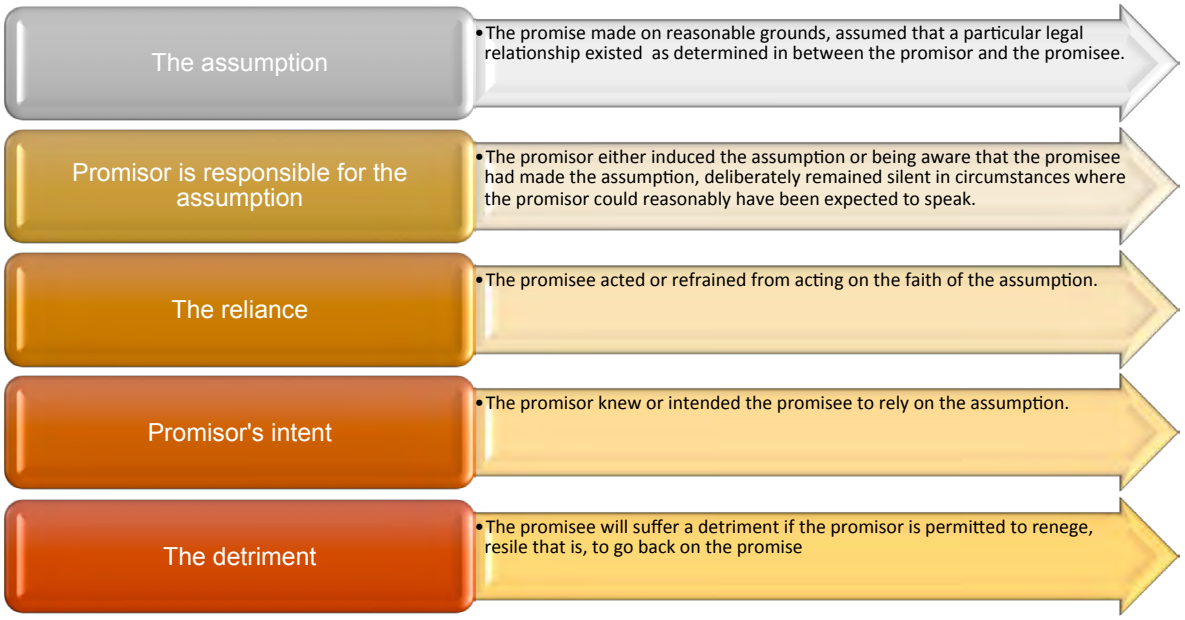


Figure 13.1 Elements of Promissory Estoppel.

13.2 Promissory Estoppel

The established modern law of promissory estoppel acknowledged a modified version of promissory estoppel as developed in equity. Nowadays, the general principles that were formulated for establishing the situations when the application of promissory estoppel is deemed appropriate include situations where:

- A representation must be made;
- The representation must be clear, whether expressed or implied; and
- The party relying on the representation must be placed at a material disadvantage because that representation has not been honoured

Over time there was an expansion of this principle in equity in common law courts and thus, the circumstances in which the doctrine of promissory estoppel now applies has been extended as initially arose in *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130 to situations where:

- There is a pre-existing contractual relationship between the parties.
- One part to that relationship, that is the promisor, voluntarily makes a clear, precise and unambiguous promise to the other party, the promise that strict performance of that person's obligations under the legal relationship will not be insisted upon.
- The promise is made with the knowledge and intention that it would be acted on by the promise.
- The promisee acts on the promise ad suffers a detriment through altering their position in reliance on the promise; and
- It would be unjust or inequitable to allow the promisor to 'resile' that is go back on the promise.

In these situations the promises could defend a breach of contract action brought by a promisor who had gone back on their promise and who was suing under the original contract terms. The doctrine of promissory estoppel as determined by the decisions of the courts is a very important doctrine and has great impact and significance for the law of contract and overall business and commercial transactions against harsh, unjust, oppressive or unconscionable conduct by one of the parties to a contract when attempting to go back on their promise which could give rise to harm or detriment to the innocent party.

13.3 Operation of Promissory Estoppel

Promissory estoppel operates in that it allows a promise to be enforced even though the promise has not provided consideration for that promise. The doctrine of promissory estoppel operates where it would be inequitable (unfair), or unconscionable for the promisor not be held to their promise. Promissory estoppel cannot be used in all situations and certain elements have to be present in order for an action under promissory to be permissible. Where these elements have been satisfied, promissory estoppel may be used as a defence or to initiate or commence proceedings in a court if the promisee's contractual position has been changed or altered in an adverse way for which loss has been or may be sustained in reliance of the promise made by the promisor who has broken that promise.

13.4 Consideration and Promissory Estoppel

Even though the courts have been willing to enforce voluntary promises, that is those promises that are not supported by any valuable consideration, with an action for promissory estoppel under the law of equity, the general requirement that every contact must have consideration is still very relevant. promissory estoppel is only available in situations where a party can prove all of the elements of the action. Unless all of the elements can be proven, a court will not be prepared to enforce defendant's promise. In such instances, the plaintiff may be entitled to a remedy for proving their action under promissory estoppel.

In situations, however, where the plaintiff wants to establish that a valid contract exists, then the plaintiff must prove all of the elements of a contract are present, including the requirement of consideration which will then enable the plaintiff to avail himself or herself to a numerous remedies for breach of contract. In this regard there are important differences between promissory estoppel and consideration including the following:

- promissory estoppel is only relevant when voluntary promises are not actually supported by any consideration;
- the plaintiff must prove all of the elements for promissory estoppel before the doctrine will be allowed to operate; and
- breach of contract remedies are much broader and have fewer restrictions as they are designed to compensate the plaintiff for any expectation losses including loss of profit.

13.5 Application of Promissory Estoppel

Promissory estoppel is generally used to enforce certain promises that are not supported by any valuable consideration. The action under promissory estoppel does not operate to enforce all gratuitous promises that is those promises that do not have any consideration. Promissory estoppel is simply described as an equitable action that can now be used by either of the parties involved to commence a legal action for the purpose of enforcing certain promises that are not supported by consideration. In respect to an action under promissory estoppel, not all promises will be enforced by the courts. The courts will only enforce promises and provide suitable remedies to the injured party that are not supported by any consideration if they contain any of the necessary elements of promissory estoppel.

13.6 Elements of Promissory Estoppel

It appears from relevant case law, *Jorden v Money* (1854) 5 HL Cas 185 and also *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130, that the doctrine of promissory estoppel may be pleaded where the following elements are shown to exist where:

- There is a clear promise, undertaking, assurance or representation that was made by the promisor to the promise (either expressly or impliedly) and without ambiguity that the promisor will not insist on strict legal rights. The promise in essence is given with the knowledge that the other party expects or assumes that the promise will be kept even though it is not supported by consideration.
- The promise or representation encouraged a certain belief in the mind of the promise or gave rise to some form of pre-existing legal relationship between the parties, under which rights actually existed or were expected to be created.
- The promisee relied on the promise by undertaking an act or acts or refraining from undertaking an act or acts on the basis that the promise would be honoured.
- The promisee would suffer material detriment and would be worse off, if the promisor was allowed to resile (go back on their word) from the promise.
- The promisor acted unconscionably and in this instance the court will not intervene unless the party pleading promissory estoppel can show that it would be unjust or inequitable to allow the other party to renege or resile (that is, to go back) from the promise, undertaking or assurance.

13.7 Remedies for Breach

The court will generally attempt to eliminate the detriment that has been suffered. In appropriate cases, an award of damages may be a sufficient remedy under promissory estoppel. However, in other cases, it may be appropriate and necessary to hold the promisor to his or her promise and not go back on their word. Accordingly, the remedies that are available for an action under promissory estoppel are different from remedies that are available for breach of contract. The available remedies for an action in promissory estoppel depends on the given situation and facts and can be from the maximum remedy available to the minimum remedy that is available. The maximum remedy that is available for an action in promissory estoppel action is giving effect to the expectation that is held by the promise. This expectation is similar to a breach of contract remedy because of the fact that it actually fully compensates the promisee, for relying on the expectation of the promise, in terms of both reliance loss and expectation loss, as a consequence of the promisor's broken promise.

The difference between the 'maximum' category and the 'minimum' category remedy that can be awarded to an injured party for an action in promissory estoppel is reliance-based loss. When compensation is given to the promise for reliance loss it is the same as saying that they are only entitled to the 'minimum equity' to justice between the parties. As opposed to the maximum remedy, the minimum remedy does not compensate the promise for the full benefit or expectation. However, all that the promisee is entitled to is to be compensated for reliance loss that they have suffered as a result of their reliance on the promisor's promise and this would include any legal expenses that were incurred by the promisee.

13.8 Remedies for Promissory Estoppel

The remedies that are generally available for a promissory estoppel action differ from the remedies that are available when there is a breach of contract. The remedies that are available under promissory estoppel range in respect to the maximum and minimum remedy that is available. The maximum remedy basically gives effect to the expectation that is held by the promisee and this is normally equivalent to a breach of contract remedy. This is because it compensates the promise in full both in terms of reliance loss and expectation loss, for the harm or detriment that was caused by the promise that was broken by the promise.

It is also important to understand the concept of detriment in promissory estoppel. Failure by the promisor to carry out the promise will not itself amount to a detriment. Promisee's must how that they acted in reliance on the promise and that as a result of doing so, they will suffer a material disadvantage if the promisor does not honour the promise. This differs from the minimum remedy that can be awarded for a promissory estoppel which whose action is reliance-based loss. In this instance, al that the promisee is entitled to is to be compensated for reliance loss that has been suffered because of their reliance on the promisor's promise and which would ordinarily include legal expenses that had been incurred by the promise in the action.

Key Points

The key points in this module are:

MO1: **Meaning of promissory estoppel:** promissory estoppel is a form of estoppel based on reliance of the terms of the agreed contract. The essence of the doctrine of promissory estoppel is to hold a party who makes a promise to another party accountable for any detriment that is suffered by the other party in reliance of that promise, despite an absence of consideration (such a promise unsupported by consideration is not enforceable as a contract).

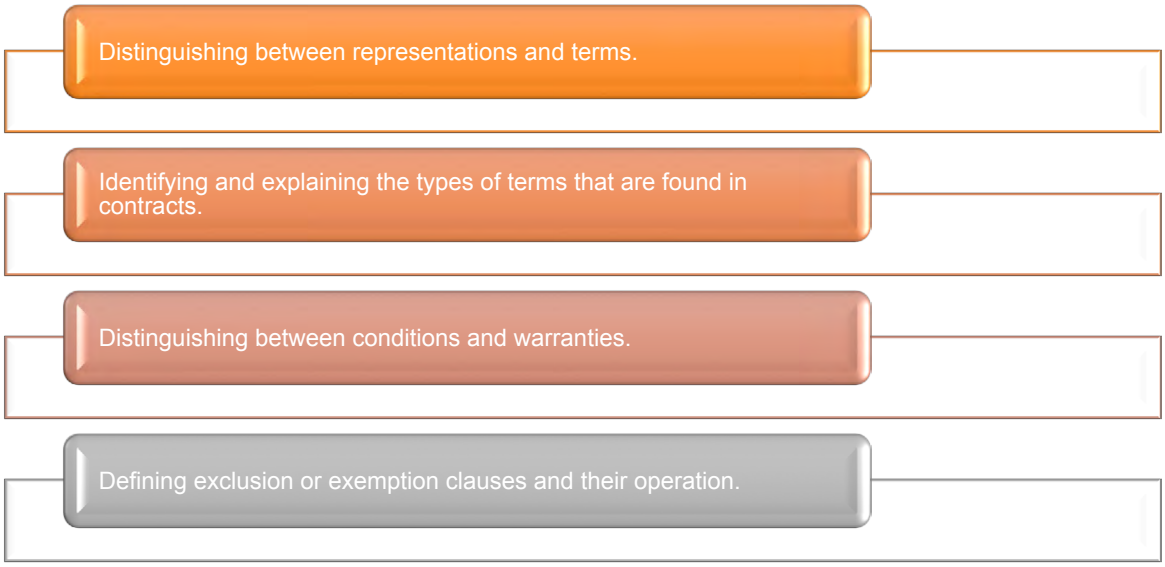
MO2: **Explaining the importance of promissory estoppel in relation to the issue of sufficient consideration:** promissory estoppel will a promise to be enforced in some situations, even though the promisee has not provided sufficient consideration for that promise.

MO3: **Legal operation of promissory estoppel:** promissory estoppel operates where it is inequitable, or unconscionable for he promisor not to be held to their promise. Also, promissory estoppel may be used as a defence or to initiate a cause of action if the promisee's position has been altered in reliance on the promise.

Module 14 Introduction to Terms

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Collateral Contract: A collateral contract is a preliminary contract upon which the main contract is based.

Condition: is a stipulation going to the root of the contract, allowing the injured party the right to rescind and/or claim for damages.

Condition Precedent: a term in a contract that delays the vesting of the right until the happening of the event under the contract.

Condition Subsequent: the term in a contract that destroys the right upon the happening of the event.

Exclusion Clause: is a contractual term in contracts that attempts to limit or exclude the liability of the person inserting the clause into a contract.

Innominate or Intermediate Terms: are contractual terms, the remedy for the breach of which depends on the seriousness of the breach instead of upon the classification of the terms as a condition or a warranty.

Parol (oral or spoken) Evidence Rule: the rule of evidence which states that additional oral (spoken) evidence is not considered by the courts to contradict, vary, add or subtract from its terms when a contract is complete on its face.

Warranty: is a term of lesser importance to the main purpose of the contract and which, of breached, only allows the injured party to claim for damages.

Key Cases

Associated Newspapers Ltd v Bancks (1951) 83 CLR 322
Balmain New Ferry Co Ltd v Robertson (1906) 4 CLR 379
Balfour v Balfour [1919] 2 ALL ER 760
Causer v Brown [1952] VLR 1
Con-Stan Industries (1986) 160 CLR 226
Curtis v Chemical Cleaning and Dyeing Co [*1951*] *1 KB 805*
Daly v General Steam Navigation Co Ltd [1979] 1 Lloyds Rep 257
Darlington Futures Ltd v Delco Australia Pty Ltd (1986) 68 ALR 385
de Lassalle v Guildford [1901] 2 KB 215
Ellul v Oakes (1972) 3 SASR 377

Head v Tattersall (1871) LR 7 Exch 7
Hillas & Co Ltd v Arcos Ltd (1932) 147 LT 503
Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd [1962] 1 All ER 474
Hopkins v Tanqueray (1854) 15 CB 130
Hutton v Warren (1836) 1 M& W 466
Oceanic Sun Line Special Shipping Co Inc v Fay (1988) 62 ALJR 389
Olley v Marlborough Court Ltd [*1949*] *1 KB 532*
Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound No 1) [1961] AC 388
Pym v Campbell (1856) 6 E and B 370
Sydney City Council v West (1965) 114 CLR 481
Van Den Esschert *(1854) 15 CB 130*

Introduction to Terms

When it has been determined that a valid and legally binding contract has been negotiated between the parties and actually formed, it is then necessary to ascertain the precise and exact content and terms of the contract that is, establishing how it was constructed or created, depending on what the parties have consented and agreed or promised to do and to be legally bound by their negotiation. This issue sometimes gives rise to many problems and contractual disputes. This module deals with the problem of what the contract actually says, that is, what the actual terms of the contract are whether they have been expressed (written down), implied terms, innominate or intermediate terms. A term of a contract constitutes an undertaking (or promise or obligation) which is intended to have legal effect as part of the contract being negotiated. It is necessary to distinguish actual 'terms' in a contract from mere representations. The main distinction is that representations are made as part of the negotiating process prior to the contract actually being formed and entered into and representations, are not intended to form part of the contract as is illustrated by *Hopkins v Tanqueray* (1854) 15 CB 130.

In respect to this discussion of terms in the contract, it is necessary to take into account exclusion clauses, which are often inserted in contracts for the purpose of excluding one party from liability or loss. Essentially what has to be ascertained when discussing the construction of a valid contract and hence its terms, is the actual extent and scope of the rights and obligations that the parties have actually entered into by their agreement. The only way of deciding this important aspect in respect to the rights and obligations is in deciding what are the terms and/or conditions of the contract, and then ascertain their actual meaning and relative importance in respect to what has been agreed to the parties to the contract including any exclusion clauses, which operate to exclude one party from liability or loss if there is a breach of contract.

14.1 Terms of a Contract

The rights and obligations of parties to a contract are determined by the terms of that contract. These terms may be expressed that is those terms that are agreed to by the parties, either in written and/or oral form or by implication. Terms might be implied by common law, as a result of conduct of the parties, (*Hillas & Co Ltd v Arcos Ltd* (1932) 147 LT 503) necessity or normal commercial practice or by statute which is now much more common in the case of consumer contracts. Once a contract has been formed and the terms of the contract identified, those terms depending on the nature and type as agreed to under the contract impose various obligations on each party.

This means that if a term remain unperformed or a party has not performed a term of the contract exactly as promised the innocent party can commence an action for breach of contract. However, before being able to ascertain the type of terms that have stipulated in the contract it is essential to distinguish between actual terms and mere representations. Mere representations do not form part of a binding and legal contract and therefore if a representation has been breach the innocent party can only rely on remedies that lie outside the contract and will arise in common law and equity in respect to for example an order for specific performance or under statute. See *Hopkins v Tanqueray* (1854) 15 CB 130. For a breach of a representation that formed an important aspect of the contract relief for the innocent party will generally be available under common law under the law of misrepresentation or under statute in respect to consumer protection provisions for misleading and deceptive statements and representations that have caused some haem or loss.

14.2 Terms and Mere Representations

The actual contents of a contract are what the parties have agreed to during the negotiations. Once it has been established that a contract exists between the parties the exact contents of that contract must be determined or ascertained. Generally, when doing business and entering into commercial contracts one of the most difficult aspects of doing business is ascertaining the actual terms, conditions and content of the contract. In respect to contract law the contents of a contract refers to what the parties have actually agreed to do, and these 'things' that they agreed to do 'constitute', 'shape' or 'form' the basis of the actual contract. When it has definitely been determined from the conduct of the parties that an actual 'contract' in its fullest sense has been created and exists between the parties, then the next important task is to determine the 'exact contents' of that contract, that is what was it that the parties agreed to and consented to in the contract.

Even though at this stage a contract has been ascertained and deemed to have been created it does not automatically mean that it is binding and enforceable, until and unless all the specified terms and conditions contained in the contract have been complied with as stated by the agreement between the parties. The reason for this is that the terms are not clear, are vague and ambiguous and may lead to absurdities or unconscionable conduct which may cause financial harm or detriment to one of the parties. The courts have taken into account a number of factors and have applied an objective test of the 'reasonable person' to enable it to ascertain and distinguish between a term and a mere representation in any circumstance. The parties may also have different views and opinions as to what was actually agreed during the course of the negotiations.

Statements or promises that are made between the parties can be classified into different groups of representations, such as sales talk or sales puffs, opinions, statements of fact, statements as to the future, predictions and estimations and actual terms in a contract such as express terms or implied terms. The actual terms of a contract that has been formed between parties may in certain situations be excluded or liability and obligations limited by the operation of specific exclusion clauses within the contract which may or may not have been written and signed during the course of the negotiations that led to the contract being formed.

These exclusion clauses will only be invoked upon the happening of an event such as a breach of a vital term of the contract or if there was fraud or negligence. It can sometimes be difficult to classify statements (oral or written) made prior to entering into a contract. This is because during the course of the negotiations, some of the statements made between the parties have no contractual importance and have not impact on the final contract. These pre-contractual statements are called mere representations or non-contractual representations which are *statements that may be both a term and a representation the word 'mere' is used here to refer to representations that are not also terms.* These pre-contractual statements that are mere representations do not confer any rights on the party to whom they are directed. This means that if the parties had wanted these statements made during the course of the negotiations to be binding they could have actually made them legally binding by stating their contractual intention that this is to be the case in the given contract.

The categorisation of these terms is important because it will impact upon the remedies available in the event of a breach of the term. The representations or pre-contractual statements are statements that are made prior to the contract and not intended to be legally binding and are classified as either:

- Sales puff, sales talk, and advertising;
- Personal opinions;
- Statements of fact and as to the future.
- Predictions and estimations.

These types of pre-contractual statements such as sales puffs and opinions are exaggerated marketing statements that operate by inducing a party to actually enter into that particular contract or to buy a particular product. In respect to sales puff and advertising they are not generally intended to have any legal effect and no remedy will be available in those situations. A representation is a statement that induces one party to enter in to the contract but that is not part of the contract and not actionable under contract law. However, these types of pre-contractual statements or representations if they are false, will enable the innocent party to take action and seek a remedy under consumer protection provisions. If these representations are intended to be legally binding and enforceable they are referred to as terms of a contract. Sometimes the term may give rise to a collateral contract which is a preliminary (collateral) statement made by the parties before they entered into the main contract which may be enforceable as is illustrated by the case of *de Lassalle v Guildford* [1901] 2 KB 215.

14.3 Types of Terms

Terms in a contract are those pre-contractual statements that are to be binding and form the contract and as are mentioned below and is illustrated by Figure 14.1 Types of Pre-contractual Statements and are either:

- express or implied; or
- written or verbal (oral).

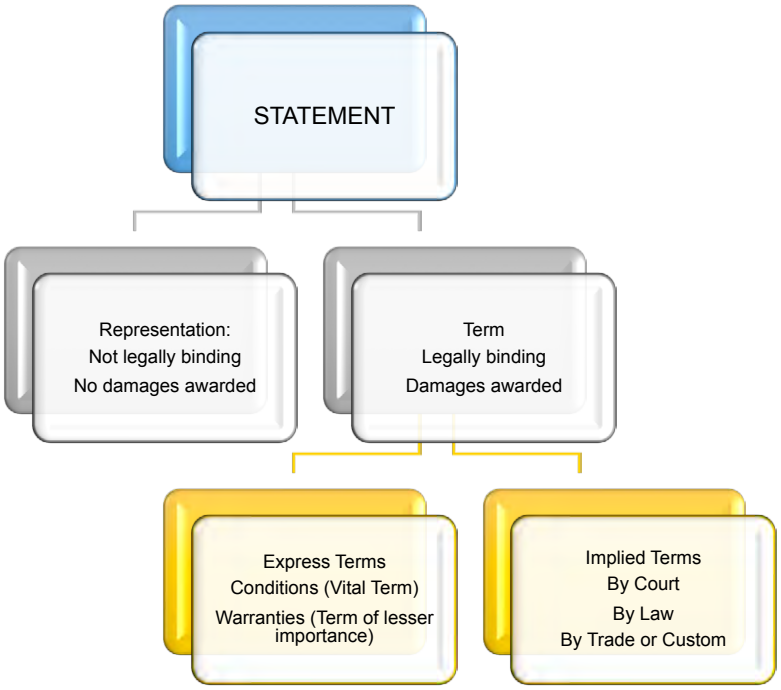


Figure 14.1 Types of Pre-contractual Statements.

Additionally, these expressed or implied terms as illustrated by Figure 14.2 Different Kinds of Terms, can be further classified as either:

- Condition;
- Warranty; and

Innominate or intermediate terms.

In respect to the differences and application of conditions and warranties by the courts see *Associated Newspapers Ltd v Bancks* (1951) 83 CLR 322 and *Ellul v Oakes* (1972) 3 SASR 377.

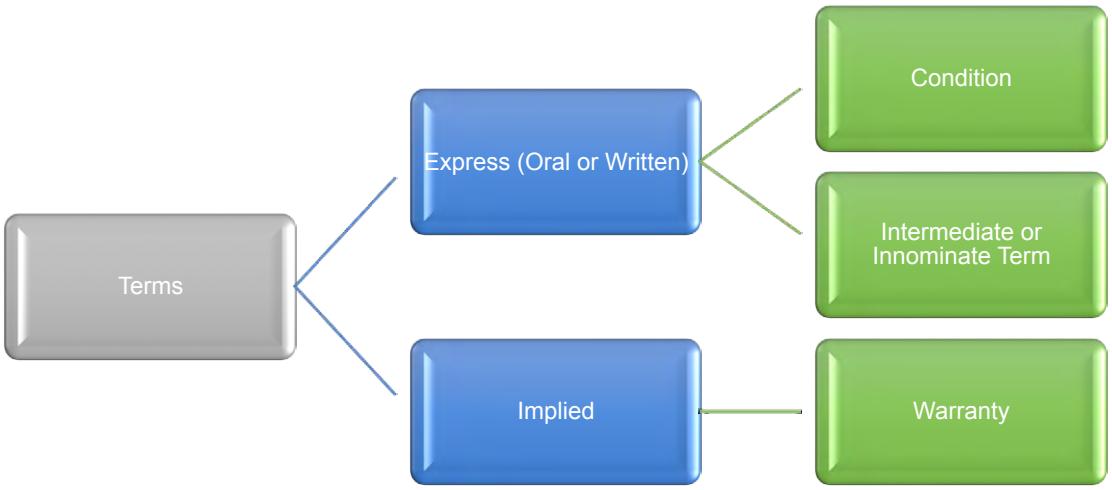


Figure 14.2 Different kinds of Terms.

Terms can be also implied into contracts as is illustrated by Figure 14.3 Types of Implied Terms, into Contracts to give effect to the intentions between the parties (business efficacy') as illustrated by Figure 14.4 Express and Implied Terms by the following ways (in this context see also Table 14.1 Ways in which Terms are Implied into Contracts):

- Common law;
- Custom or trade usage; and
- Acts or Statute.

Figure 14.3 Types of Implied Terms

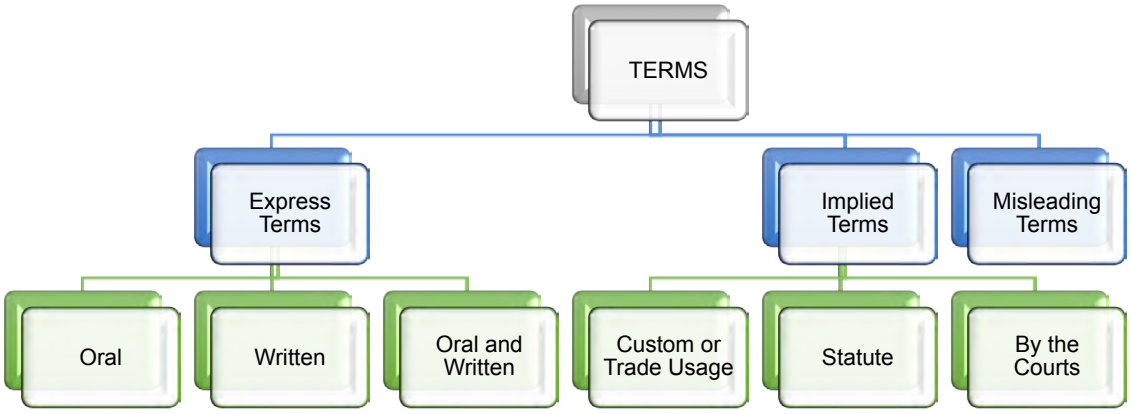


Figure 14.4 Express and Implied Terms

In should be highlighted that in respect to written or expressed contracts, the main view is that if they are entirely written then the document itself constituting the formal contract, will actually contain all of the stipulated terms of the contract. This general view at law is commonly referred to as the parol evidence rule. This rule operates to prevent and restrict the parties to a written contract from providing other extrinsic that is outside the contract that would contradict the written terms of the contract. With oral or verbal contracts, the terms will be determined by the words actually used by the parties when the contract was formed. This is generally a question of fact and decided by the court depending on the circumstances and will be determined from evidence obtained from the parties themselves and reliable independent witnesses.

By the Court	By Custom or Trade Usage	By Statute
• Terms implied by the court to overcome an oversight or ommission in order to give 'business efficacy', that is, to give effect to the intention of the parties to the contract.	• Terms implied on the basis of established practice or custom in a particular trade, industry, market or workplace, or between members of a particular group under which agreements are carried into effect in a certain and unique manner inherent to that business. Such terms are so well known that by implication they actually become part of contracts of the same type in that industry.	• Terms implied by State and Federal Legislation such as *Sale of Goods Acts, Fair Trading Acts* and *Consumer Protection Acts* which imply terms into contracts for the sale of goods and services in order to protect consumers irrespective of the intentions of the parties to the contract.

Table 14.1 Ways in which Terms are Implied into Contracts

14.4 Terms or Mere Representations

To enable the Courts to determine if a statement that has been made is an actual tem of the contract or a mere representation, it attempts to give effect and commonly referred to as 'business efficacy' to the intention of the parties. The court makes this determination by applying the objective test of the reasonable person. That is, what would a reasonable person believe to be the parties' intentions in regard to the contractual nature, basis and force of the statement that was made during the negotiation phase that led to the formation of the contract.

In determining whether the statement that was made by one party is in fact of a promissory nature and a term, or is non-promissory and only amounts to a mere representation made during the non-contractual phase the court will usually look at the following factors:

- the language that was used by the parties;
- the context in which the statement was actually made;
- the time the statement was actually made;
- the maker of the statement; and
- the actual importance of the statement.

These factors and the importance for their distinction as a term or mere representation in determining if a pre-contractual statement is an actual term or mere representation is illustrated by a number or relevant cases in this important area of terms of a contract.

14.4.1 Terms and Mere Representations Distinguished

The main reasons for the distinction between a term and a mere representation is in respect to the type of remedy that is available as a result of a breach. For an actual breach of a term, damages are available to the innocent party as a remedy for any loss sustained as a direct result of the breach. Where there has been a false representation (misrepresentation) damages or monetary compensation are usually not available unless the representations that were made are fraudulent or negligent. This distinction is important as it relates to the type of damages that can be claimed. For example damages for fraudulent or negligent misrepresentation is permitted under the tort (civil wrong) of deceit or negligence.

However, if the misrepresentation is innocent is then there will be no damages available because there is no tort or civil wrong done to the plaintiff. Apart from damages (monetary compensation) the innocent party in a situation of misrepresentation may also be entitled to the equitable remedy of rescission. Under rescission where available, it entitles the innocent party to set aside the contract from the beginning because the contract is effectively being treated as not have been entered into and formed at all between the parties.

The equitable remedy of rescission which is different to the right to terminate under the common law is subject to a number of limitations referred to as the 'bars to rescission'. If a breach of an actual term under the contract has taken place and the term is of vital importance to the contract and is a condition, then the innocent party will be entitled to terminate the contract from the time of the breach. If this occurs, then contractual obligations and performances that have been performed before the breach will remain enforceable. If for instance, a breach of warranty, condition or innominate or intermediate term has occurred, the innocent party will only be entitled to sue for damages.

14.5 Expressed (Written) Terms

The rights and obligations of parties to a contract are determined by the terms of that contract. These terms may be express, which are those articulated by the parties and can be in written or oral form or implied as is illustrated by Figure 14.4 Express Terms in Contracts. Terms might be implied by common law, as a direct result of conduct of the parties, necessity or normal commercial practice or by statute, which is now much more common especially in the respect to consumer contracts.

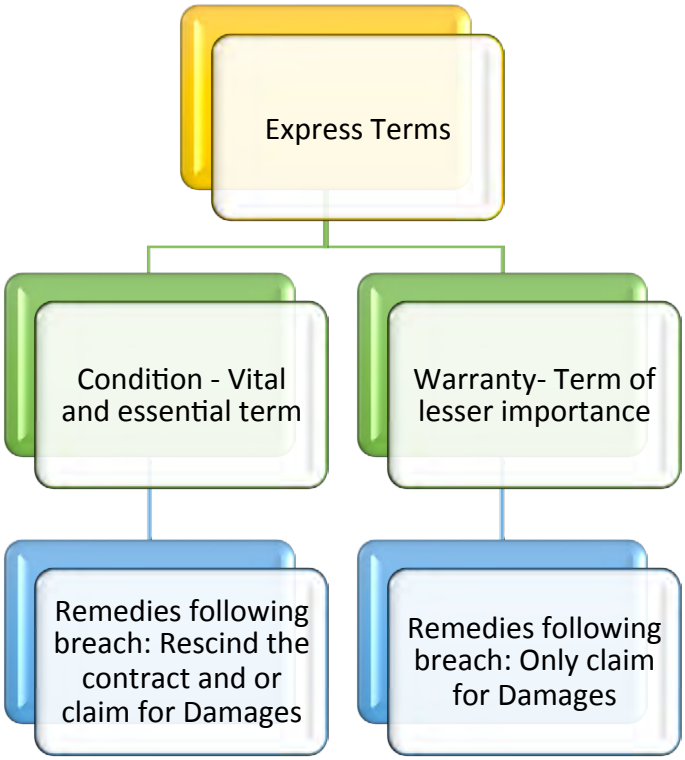


Figure 14.4 Express Terms in Contract

During the negotiations of the terms of the agreement and leading up to the actual formation of the contract the parties may make many statements, some of which are intended to form part of the contract while others are not intended to be contained in the contract. These statements may take the form of assertions of fact or promises or opinions, and some may be made orally while others may be expressed that is put in writing which brings into operation the parol evidence rule. Some statements may be in a document while others may be in some other written form and may or may not be signed by the parties.

Additionally, in some situations the oral pre-contractual statement may be treated as a collateral contract, which in some circumstances the court will enforce on its own if deemed necessary and to give 'business efficacy' to the intentions of the parties. In the event of a contractual dispute regarding the meaning of a contract, it becomes necessary to construe, that is interpret the exact terms of the contract in order to ascertain the genuine and true intention of the parties. These specific terms are commonly referred to as clauses, stipulations or provisions which are generally contained in the expressed or written contract.

Express terms are terms that are specifically created by the parties, which they intended to be part of the contract. In contracts that are actually written, express terms will be terms that are agreed to by the parties at the time of negotiation of the agreement. In respect to oral contracts, the express terms are those terms that are spoken, that is made orally, and actually agreed to between the parties. Express terms are those terms that the parties have articulated prior to or at the time of actually concluding their contract. Sometimes identifying these terms is an easy and simple task, for example, if they appear in a written contract and on other occasions it is less clear and more complicated to ascertain the exact and expressed terms made by the parties as a result of representations often referred to as pre-contractual statements.

14.6 Exclusion or Exemption Clauses

Apart from actual terms that form a very important aspect of the contract that has been formed and generally will provide the innocent party with remedies under the common law, equity or statute there exists 'exclusion' clauses in the contracts. An exclusion clause is a term of the contract, which operates to limit or exclude liability from one party which it would otherwise be subject to under the terms of the contract as formed between the parties. An exclusion clause (in the context of contract law) is a term of a contract which seeks to limit or exclude liability for contractual breach. Exclusion clauses, if properly drafted, are generally effective as is illustrated by the cases *Balmain New Ferry Co Ltd v Robertson (1906) 4 CLR 379; Causer v Brown* [1952] VLR 1; *Curtis v Chemical Cleaning and Dyeing Co* [*1951*] *1 KB 805; Daly v General Steam Navigation Co Ltd* [1979] 1 Lloyds Rep 257; *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 68 ALR 385; *Olley v Marlborough Court Ltd* [1949] 1 KB 532 and *Sydney City Council v West* (1965) 114 CLR 481. However, there are some statutory provisions which prevent or limit the use of exclusion clauses in some cases, especially in relation to consumer contracts). The main function of an exclusion clause is that it limits or excludes liability for breach of an express term or an implied term, or even negligence in a contact. In general the courts' approach to interpreting exclusion clauses is to interpret them narrowly in order to avoid any oppression, unjust or unequal bargaining position between the parties. Thus, the courts will narrowly construe exclusion clauses because they are of the view that exclusion clauses can in some instances produce harsh and unconscionable results for consumers and parties who are at a disadvantage and in an unequal bargaining position. Exclusion clauses operate to effectively transfer the risk of loss arising from the sale or supply of a product or good or service away from the supplier or purchaser.

14.7 Parol Evidence Rule

Where the parties have expressed their agreement totally in writing, the 'parol evidence rule' applies. This rule states that if the written document is intended by the parties to the agreement to contain the complete record of their negotiation, outside or extrinsic evidence is not permitted to add to, vary or contradict the written document and was is contained in the 'four corners' of the page and is highlighted by decided cases such as *Hutton v Warren* (1836) 1 M& W 466; *Pym v Campbell* (1856) 6 E and B 370 and *Van Den Esschert* (1854) 15 CB 130.

However, in some instances the rigorous and strict operation of the parol evidence rule cannot be applied and accordingly the court has allowed certain exceptions to the parol evidence rule which relate to the admission of 'extrinsic' or outside evidence to alter or amend the written (expressed) terms of the contract. The exceptions to the parol evidence rule allowing extrinsic evidence to be presented includes evidence that can be admitted to:

- show a custom, trade usage or past dealings, which is part of the contract;
- clarify any unclear language used in the written contract;

- clarify the subject matter or parties in the written contract, provided evidence is only given to explain the terms used and not to alter them;
- show that the written document represents only part of the agreement;
- show that the written agreement between the parties was entered into subject to a verbal condition, which has not been fulfilled;
- show that the written contract is not binding because there is evidence of misrepresentation, fraud, duress or undue influence which destroys genuine consent;
- show that a subsequent oral agreement rescinded the original written agreement; and
- show that a collateral contract exists.

In situations where the contract is partly oral, and the parol evidence rule only applies if the agreement is totally in writing, evidence is generally admitted as evidence to show that an agreement is partly written and partly oral.

14.8 Collateral Contracts

An oral statement made during the course of the negotiations of the contract and referred to as pre-contractual statements or representations may in some instances be treated as a collateral contract. A collateral contract which is a preliminary (collateral) statement made by the parties before they entered into the main contract which may be enforceable as is illustrated by *de Lassalle v Guildford* [1901] 2 KB 215.

A collateral contract has the following features which are taken into consideration when determining if it is to be enforceable:

- it involves an oral statement;
- the main contract is actually written;
- the entering into of the main contract is the consideration for the oral assurance or promise;
- a breach of the oral promise will entitle the innocent party to damages;
- the collateral contract must not be inconsistent with the terms of the main contract; and
- the oral statement must be intended as a promise, that is, to have contractual effect and not a mere representation.

A collateral contract is a contract in its own right and it is separate from the main contract. This effectively means that if for some reason the man contract is illegal and unenforceable, then the collateral contract may still be enforced on its own. A collateral contract may also be enforced if the main contract is one that is required to be in writing or evidenced in writing and the collateral contact is not required to be in writing or evidenced in writing such as contracts for the sale of land.

14.9 Type of Express Terms

Once it has been determined that a particular pre-contractual statement is in fact an actual term of the contract, then the court has to determine what kind of term it is, and therefore the importance to be attached and placed on that particular stipulated term. This is necessary because the remedies that are actually available to the innocent party for a breach of a term will vary according to the significance and importance that is actually placed on that term. As it is obvious the greater the importance and significance of the term the greater the remedy will be that is available to the innocent party as a result of the breach of that very important and vital term.

As is illustrated by Table 14.1 Different Kinds of Terms, when a pre-contractual statement or representation actually becomes a stipulated and essential term of the contract that is performed, then they can be classified as either a:

- condition: *Associated Newspapers Ltd v Bancks (1951) 83 CLR 322 and Ellul v Oakes* (1972) 3 SASR 377;
- warranty: *Associated Newspapers Ltd v Bancks (1951) 83 CLR 322 and Ellul v Oakes* (1972) 3 SASR 377
- innominate or intermediate term: *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 1 All ER 474;
- condition precedent or condition subsequent: *Head v Tattersall* (1871) LR 7 Exch 7 and *Pym v Campbell* (1856) 6 E and B 370.

14.9.1 Condition or Warranty

Subsequent to the court establishing, whether a statement is not just a representation by an actual term of a contract it is then necessary to determine and establish the importance of the statement made because the remedies available to the injured party will differ depending on whether the term is a condition or a warranty. Courts apply the 'essential test' in determining if the specific term of the contract is a condition or a warranty looking at the facts and circumstances surrounding the initial negotiation and subsequent formation of the agreement. In doing this the courts look at the contract as a whole and will ascertain if the statement is very important to the innocent party, and would not have entered into the contract unless that particular promise was made.

The distinction of the term of a contract as either a condition or a warranty is based on the fact that not all of the obligations that are created under the contract are of equal importance and this has been acknowledged by the law of contract by the distinguishing the terms as either of great important and vital that is the condition or a term of lesser importance the warranty. If the term cannot be classified as either a condition or a warranty it is referred to as an innominate or intermediate term and lies in between a condition and a warranty and this different is illustrated by Figure 14.5 Importance and Significance of Terms.

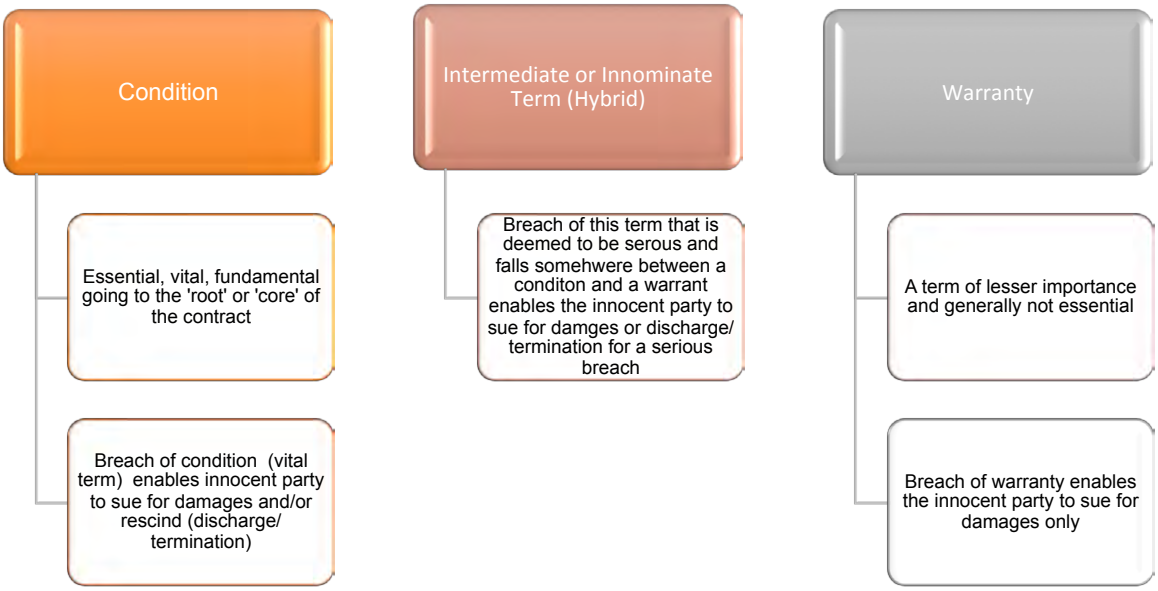


Figure 14.5 Importance and Significance of Terms

14.9.2 Condition (Important Vital Term)

A condition is a term that is 'vital' and goes to the root of the contract. It is extremely important that if the term not performed as promised and is breached there is a substantial failure to abide by the promises made under the contract. Thus, the non-performance by the party in default will enable the innocent party to set the contract aside or sue for damages or both. If the breach of a condition does not have a serious effect on the contract then it will be treated as a warranty and the inured party will only be entitled to damages.

To determine whether a term is a condition or a warranty the courts apply an objective test by ascertaining the intention of the parties as it appears in or from the contract and at the time that the contact was entered into. This means that the courts will apply an objective test looking at the case as a whole and considering the importance of the broken term and stipulation and to ascertain if the stipulation is essential or unessential to the contract. Therefore if the stipulation is deemed to be essential that it is a condition and if it is not then it is treated as a mere warranty.

14.9.3 Warranty (Lesser Insignificant Term)

The other term in an express or oral contract is a warranty. A warranty is a term of lesser importance to the main purpose of the contract. If a warranty is breached, it only allows the inured party to only claim for damages for any loss that they may suffer as a direct result of the breach.

14.9.4 Innominate (Intermediate) Terms

Sometimes there are other terms that cannot be classified as either a condition or warranty until after the breach of contract has occurred. The courts have identified an additional class of terms that lie between conditions and warranties and they are called innominate or intermediate terms. The case that illustrates the circumstances where a serious breach of an innominate term will entitle the innocent party to treat the contract at an end and therefore rescind the contract and/or sue for damages. In respect to these terms the court is concerned with how serious the effects of the breach are on the contact, instead of trying to classify the term that has been broken as being either a condition or a warranty. This is because merely classifying an innominate or intermediate term as a condition or warranty does not in some instances determine its legal effect, but is determined after a breach of the contract has eventuated and is dependent on the particular circumstances surrounding the breach and consequent loss by the innocent party. See Table 14.2 Contract Terms – Condition, Warranty and Innominate Term.

Condition	Warranty	Innominate or Intermediate Term
• A condition is a 'vital' and essential term of a contract and its non-performance may result in rescission and/or damages to the plaintiff.	• A warranty is a term of lesser importance and is not essential to the main purpose of the contract and the plaintiff is only able to sue for damages under the contract if there is a actual breach.	• An innominate or intermediate term arises in situations where the court focuses on the seriousness of the effects of a breach of contract by this term and in this instance the plaintiff can elect to accept or rescind the contract, and damages are available in either case.

Table 14.2 Contract Terms – Condition, Warranty and Innominate Term

14.9.5 Condition Precedent

In respect to the definition of a term, the word 'condition' can also be used to refer to a stipulated term that unless and until it is actually satisfied and performed; it will prevent a contract from coming into existence. This means that the terms of the condition precedent will delay or stall the vesting or transfer of any rights under the agreement until the happening of the stipulated event. In essence, a condition precedent in essence is a clause or term stating that the agreement does not become a contract until the actual happening of a specified event. An example of this is a 'subject to finance' clause in the sale of land or property agreement, which if not fulfilled will cause the offer to purchase the land or property to lapse and rendered ineffective.

14.9.6 Condition Subsequent

A condition subsequent is a term in a contract that will terminate the agreement upon the happening of the stipulated event, such as for example, the death of one of the parties, the return of a specific item and exchange for another or a refund if the item is defective or unsatisfactory. The main and significant difference between a condition precedent and a condition subsequent is that in respect to a condition subsequent the contract has already been formed (executed) and is in operation between the parties. This is in contrast to a condition precedent which must be satisfied in order for an agreement to effectively become a contract and is illustrated by Table 14.3 Contract Terms – Conditions Precedent and Subsequent.

Condition Precedent	Condition Subsequent
• A condition precedent is a term that must be satisfied *before* a contract can come into existence and in this situation no enforceable contract actually exists and there is no remedy, as there is no actual breach.	• A condition subsequent is a term in a contract which provides that the contract will terminate on the happening of a particular *event* in the future and operates to terminate an existing contract and there is no remedy available as no actual breach.

Table 14.3 Contract Terms – Conditions Precedent and Subsequent

KEY POINTS

The key points in this module are:

MO1: **Distinguishing between representations and terms:** A representation is a statement of 'fact' whereas a term refers to a 'clause or condition' in a contract that is agreed upon by both of the parties to the contract which are legally enforceable and binding breach of which can provide relief to the injured party by seeking damages and a right of termination.

MO2: **Identifying and explaining the types of terms that are found in contracts:** The types of terms that are found in contracts can be either a condition, a warranty or an innominate (intermediate) term which is neither a condition nor a warranty but is still significant to the performance of the contract if of a serious nature.

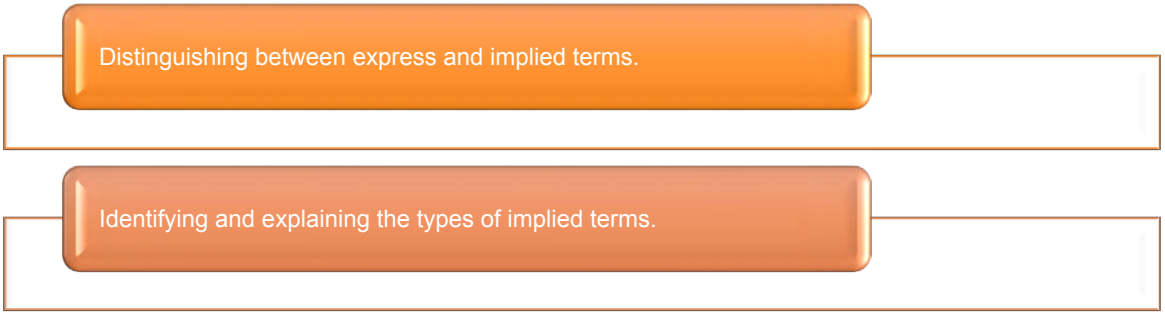
MO3: **Distinguishing between conditions and warranties:** A condition is a vital term that goes to the core or root of the contract, breach of which will usually give a right of termination to the injured party. A warranty on the other hand us a tern of lesser importance, breach of which usually does not give rise to a right to terminate, but only to seek damages.

MO4: **Defining exclusion or exemption clauses and their operation:** An exclusion or exemption clause is a contractual term that attempts to limit or exclude the liability of the person inserting it into a contract.

Module 15 Implied Terms

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Implied Terms: apart from express terms, a contract may contain a number of terms that the parties or the courts may 'read' or 'imply' into the contract.

Key Cases

Con-Stan Industries (1986) 160 CLR 226
Hillas & Co Ltd v Arcos Ltd (1932) 147 LT 503
The Moorcock (1889) 14 PD 64

Implied Terms

Even though a contract is written or expressed in an attempt to cover all promises and undertakings between the parties at the time of negotiation, it does not mean that it has covered every eventuality or circumstance that may give rise to terms that have to be complied with under the contract. This is because the most carefully written contracts cannot provide for every business or commercial event that may lead to an actual valid and legally binding contract. In less formal or oral contracts, there will also be included some terms that may not have been discussed between the parties or not even contemplated.

The courts are generally reluctant and unwilling to imply terms into a contract for the parties involved. This is because they do not see that the role or function of the courts is to make the contract for the parties involved, but rather their role is to interpret and determine what the parties had actually agreed to during the negotiation phase of their agreement before the creation of the contract. However, in some situations, it is not evident or clear from the beginning what the exact terms had been intended by the parties, because my reason of mistake, errors, omission, oversight or inadequate drafting the actual intended terms were not included into the final written or expressed contract. It is in these types of circumstances, that the courts are willing to imply and may imply terms into the contract in order to overcome the omission or oversight which if not rectified will not genuinely reflect the true intention of the parties and what they had agreed to under the contract. See the following cases which illustrate where the courts have implied terms into contracts for business efficacy, *Con-Stan Industries* (1986) 160 CLR 226; *Hillas & Co Ltd v Arcos Ltd (1932) 147 LT 503 and The Moorcock* (1889) 14 PD 64.

15.1 Classification of Implied Terms

Implied terms are those terms which the law implies into a contract notwithstanding the fact that they have not been discussed by the parties or referred to in a contract. Terms may be implied by the courts as a matter of law into specific kinds of contracts, such as, contracts for professional services which contain an implied term that the professional person will carry out his or her contractual duties with reasonable care and skill that is without negligence. Contracts between contractors and their customers contain an implied term that the contractor use reasonable care in performing the work and that any materials supplied in relation to the work be of 'good quality' and fit for the purpose for which they are supplied.

To cover all these various types of contracts and situations and for 'business efficacy' implied terms of the contract can consist of terms that are implied as a matter of law; terms implied as a matter of fact; and terms implied by Statutes. Accordingly, terms may be implied either at common law or by statute as is illustrated by Figure 15.1 Types of Implied Terms.

Figure 15.1 Types of Implied Terms

15.2 Common Law

At common law terms are generally implied where it is necessary to give full effect and referred to as 'business efficacy' to the intention of the parties. For example, it may imply a term requiring parties to do what is necessary to enable the contract to be performed. In some situations the courts will attempt to ascertain whether or not the parties would have expressly agreed to the term if they had considered the issue when entering into their contract. Also, in some cases the courts will imply 'standard' terms without the need for inquiry into the actual intent of the parties as they are standard implied terms which are recognised and known within a particular business trade or profession. In the case of 'standard' terms if there is a clear intention that they are not apply then those terms will not be implied in that particular contact as agreed to by the parties. Some standard implied terms can include that the materials purchased from a supplier or manufacturer are of good and merchantable quality and fit for purpose and that contracts for professional services will be supplied and will be provided with reasonable skill and care.

15.3 By Statute (Legislation)

Terms may be implied by legislation. This is now much more common so that the statutory regimes in today's' globalised economy are far more relevant than the common law principles. Statutory implied terms generally impose obligations on one of the parties and are most common in consumer contracts. At the present time to heighten consumer protection in the market place there are a number of overlapping and different statutes as is illustrated by Figure 15.2 Terms Implied by Statute.

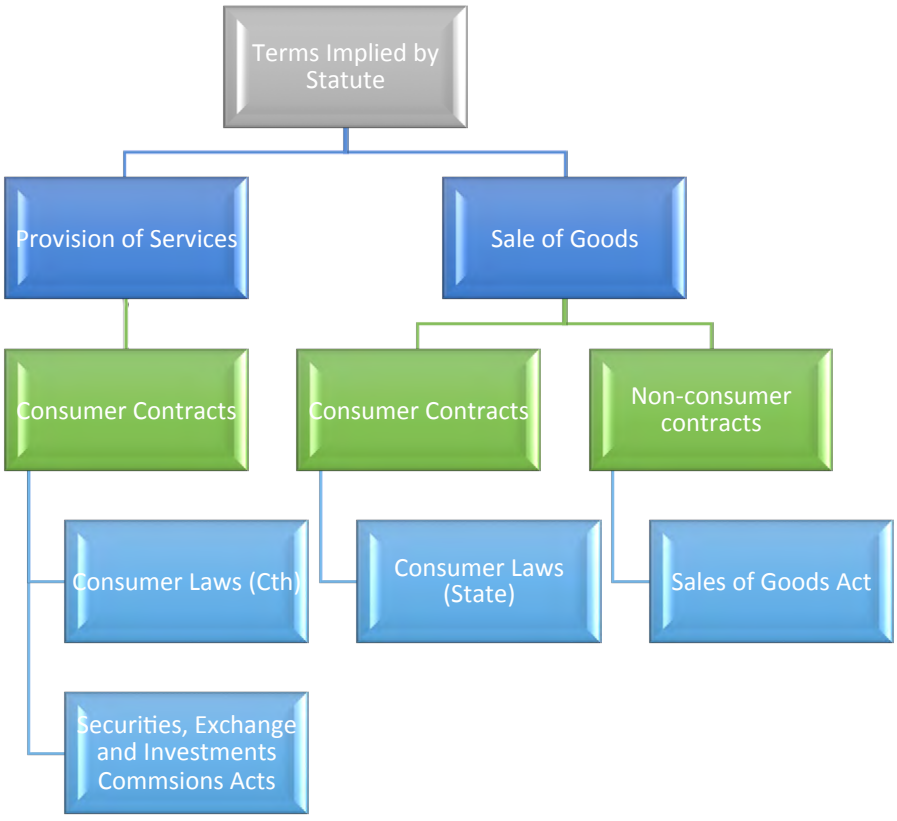


Figure 15.2 Terms Implied by Statute

15.4 Implied Terms in Contracts

In situations where a simple contract has been validly created, and there are no elements which affect its actual validity and enforceability then it is necessary to consider exactly what the parties have agreed to include in the contract in respect to rights and obligations, that is the terms, in the contract that has been entered into by the parties.

A term is defined as being a statement which will create contractual obligations between the parties, a breach of which will result in the injured party the plaintiff being able to sue for damages or rescind the contract depending on the type of term for any loss or injury as a direct consequence of the breach of the term. Terms may in certain situations be implied by the court, by custom or trade usage, prior or past dealings or by statute and may be categorised into the different types of terms such as conditions, warranties, innominate or intermediate terms, condition precedent or condition subsequent.

15.5 Terms Implied by the Court

The courts have the power as part of their inherent role and function to interpret the true intention ('business efficacy') of the parties to a contract actually imply terms into a contract. This inherent power to imply terms by the court is invoked where it is clearly obvious that the parties had intended those specific terms into the contract but as a result of an omission or oversight failed to include them into their expressed or written agreement.

The courts therefore have allowed terms to be implied into contracts as either a matter of fact or a matter of law as illustrated by Figure 15.3 Terms Implied by the Court, in order to give business efficacy to the contract, in the following situations, where the term is:

- capable of clear expression;
- *necessary* to make the contract effective;
- so obvious that it 'goes without saying' that it should be implied;
- fair and equitable to both parties; and
- not in conflict with the express terms.

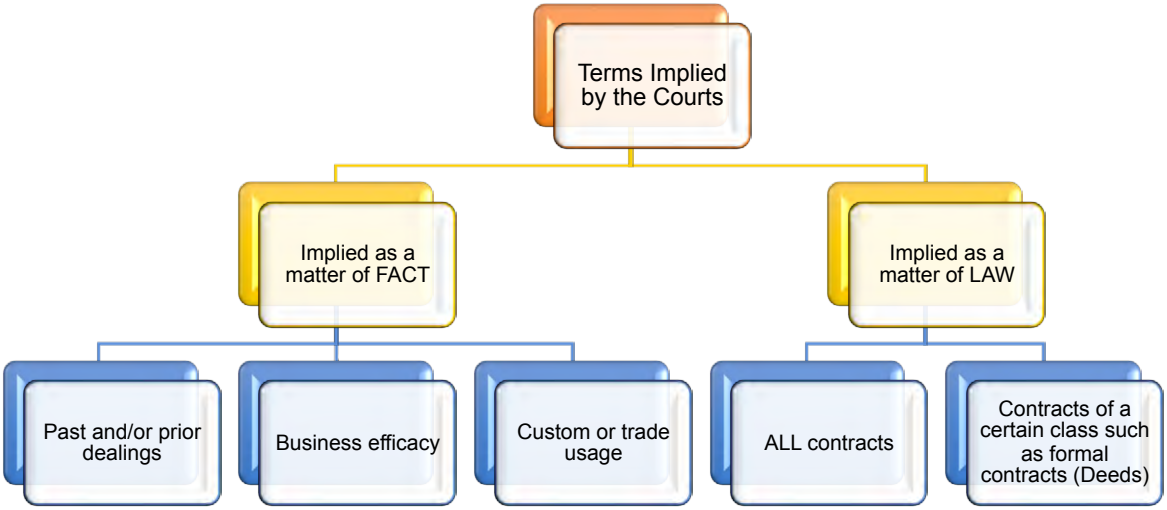


Figure 15.3 Terms Implied by the Court

Courts are able to imply terms in many situations where there has been a genuine omission or oversight of certain important and crucial terms in a contract. One situation where this arises is where there has been a prior court of dealings between the parties over a certain length or period of time. In this instance, the terms that are implied by the court are those that are used and applied in order to cure, rectify or remedy obvious omissions or to give the contract 'business efficacy', which means to give effect to the actual and true intention agreed to by the parties under the specific contract. To enable the court to imply a term into a contract, it must be deemed to be actually necessary to do so in order to give 'business efficacy' to the contract. However, in the some instances the position has been reversed by the courts and decided that some terms cannot be implied even to promote and assist 'business efficacy' in some circumstances.

15.6 Terms Implied by Custom

In situations where there is no express provision to negate the inclusion of implied terms through custom or trade usage, they can also be relied on as they are common, accepted, understood and recognised by everyone operating in that business that when making or entering into a contract they would be assumed to have included those terms into the contract which are then implied and legally enforced by the courts.

Terms therefore can be implied a result of custom or trade usage, provided:

- it is possible to state the implied term clearly;
- the custom relied on must be so well known and wide-spread that all contracts of the same type can be said to have the same term;
- the custom must be reasonable; and there is no conflict between the implied term and the express terms, provided however that the second element is satisfied, it is not necessary that both were aware of the custom.

Thus, there are many instances in business and commerce where terms can be implied into contracts even if they were not expressly agreed upon. This situation arises in business especially where there is an established custom or practice in a particular trade or profession, industry, market or workplace. In these situations the certain implied terms can form part of the contract because the parties in the particular trade or profession as a normal and ordinary course of business always contract on the basis of such specific terms inherent in that industry, trade or profession. In cases where the terms are incorporated into a contract through custom or trade usage, they are deemed to be implied on the basis of that particular custom or trade usage, and it can be enforced in exactly the same way as the express terms that are actually contained in the contract agreed to between the parties.

In some cases courts have given rise to a number of propositions that can be applied in determining whether a term will considered as being an implied term on the basis of custom or trade usage and include:-

- the existence of a custom or trade usage is a question of fact to be determined by the surrounding facts and circumstances that gave rise to the contract;
- a person need not have an actual knowledge of the custom or trade usage in order to be bound by it;
- the custom or trade usage need not be universally accepted, built must be so well known and recognised that everyone making the contract in that particular situation can be reasonably presumed to have imported that term into the contract; and
- the term is not implied on the basis of custom if it is contrary to the express terms of the contract.

15.7 Terms Implied by Prior Dealings

The courts will in certain situations imply terms as a result of past dealings between the parties if the following circumstances are present:

- the terms of the collateral contract must not be inconsistent with the terms of the main the term claimed to have been used in past dealings is clearly identifiable. This is most easily done by reference to previous contractual documents;
- the previous dealings were sufficiently frequent and consistent, given the circumstances of the case, to constitute a regular course of dealing;
- the present dealing fits into that course of dealing to the extent that it can reasonably be said that the same terms should be included; and
- there is no conflict between the implied term and the express terms.

15.8 Terms Implied by Statute

Term in contracts can also be implied by statute (see Figure 15.4 Terms Implied into Contracts) in order to enable business to operate where there is a dispute, as well as for 'business efficacy' and ensuring fair sales and services transactions, and to protect consumers, especially from unequal bargaining positions or where there has been some unconscionable conduct or misrepresentation.

By the Court	By Custom or Trade Usage	By Statute
• Terms implied by the court to overcome an oversight or ommission in order to give 'business efficacy', that is, to give effect to the intention of the parties to the contract.	• Terms implied on the basis of established practice or custom in a particular trade, industry, market or workplace, or between members of a particular group under which agreements are carried into effect in a certain and unique manner inherent to that business. Such terms are so well known that by implication they actually become part of contracts of the same type in that industry.	• Terms implied by State and Federal Legislation such as *Sale of Goods Acts, Fair Trading Acts* and *Consumer Protection Acts* which imply terms into contracts for the sale of goods and services in order to protect consumers irrespective of the intentions of the parties to the contract.

Table 15.4 Terms Implied into Contracts

Key Points

The key points in this module are:

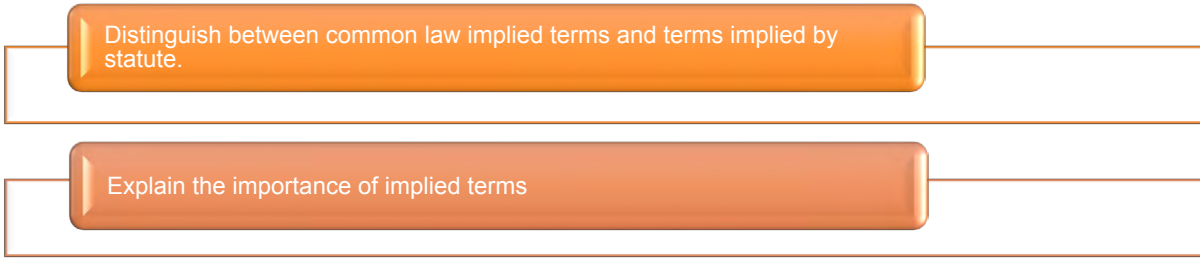
MO1: **Distinguishing between express and implied terms:** An express term is a clause or condition of that contract that is expressed or reduced to writing in the contract and can be oral, written or a combination of both. On the other hand an implied terms is derived from the conduct and prior dealings between the parties by custom or usage, by statute or by the courts.

MO2: **Identifying and explaining the types of implied terms:** Implied terms is derived from the conduct and prior dealings between the parties by custom or usage, by statute such as implied guarantees of fit for the purpose and merchantable quality of products as well as by the courts in situations of partnership based on the objective test of the reasonable person.

Module 16 Terms Implied by Statute

Module Objectives

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



Key Legal Terms

An understanding of the following basic fundamental legal terms will enable you to attain a better understanding of the topics covered in this module.

Implied Terms: apart from express terms, a contract may contain a number of terms that the parties or the courts may 'read' or 'imply' into the contract by common law and statute law.

Terms Implied by Statute

Terms may be implied by legislation of various jurisdictions and this now much more common nowadays in respect to various statutory jurisdictions and regimes which support and at times even override common law principles. Statutory implied terms generally impose obligations on one of the parties, mainly the manufacturer, seller and those giving professional advice to enhance consumer protection and are generally more common in consumer contracts.

Thus in any jurisdiction, the statutory implied terms are important because in circumstances where a contract was for the actual sale of goods, the courts adopted the approach of implying into such contracts certain terms to provide some protection to the purchaser. Over the years this matter pertaining to contracts for the sale of goods was deemed by the courts and parliament to be very important that eventually parliament enacted laws, statutes, to ensure that these implied terms became terms of the actual sale of goods contract especially in the light of increased e-commerce and globalisation. These implied terms in sales of goods contracts now form the basis of the majority of the extensive state and federal consumer protection legislation.

In respect to this area of sale of goods and consumer protection these terms where they are non-existent in the contract may be implied by the courts as a matter of fact in the given situations. Accordingly, under the various *Sales of Goods* and *Fair Trading Acts* and *Consumer Law Acts*, the actual terms that are implied in the contracts for the supply of goods by corporations and other businesses to consumers are those in respect to title, correspondence with description, merchantable quality and fitness for purpose. In respect to the supply of services by corporations there are also certain implied warranties as to quality for the supply of those services.

These implied terms form part of the actual contract for the sale of goods whether face to face transactions or via e-commerce online via the Internet and other forms of social media. These implied terms for the purpose of protecting the consumer (buyers) apply in every sale of goods transaction whether the parties have mentioned them or not in the particular sale of goods transactions. In addition to common law implied terms, specific areas of statute law generally operate to imply terms into contracts at a global level for the sole purpose of consumer protection.

16.1 Terms and Consumer Contracts

In business transactions for the sales of goods and provision of services, certain terms are implied into consumer contracts by various state and federal legislation as well as international conventions such as the *Vienna Sales Convention for the International Sale of Goods* as is illustrated by Figure 16.1 Terms Implied by Statute.

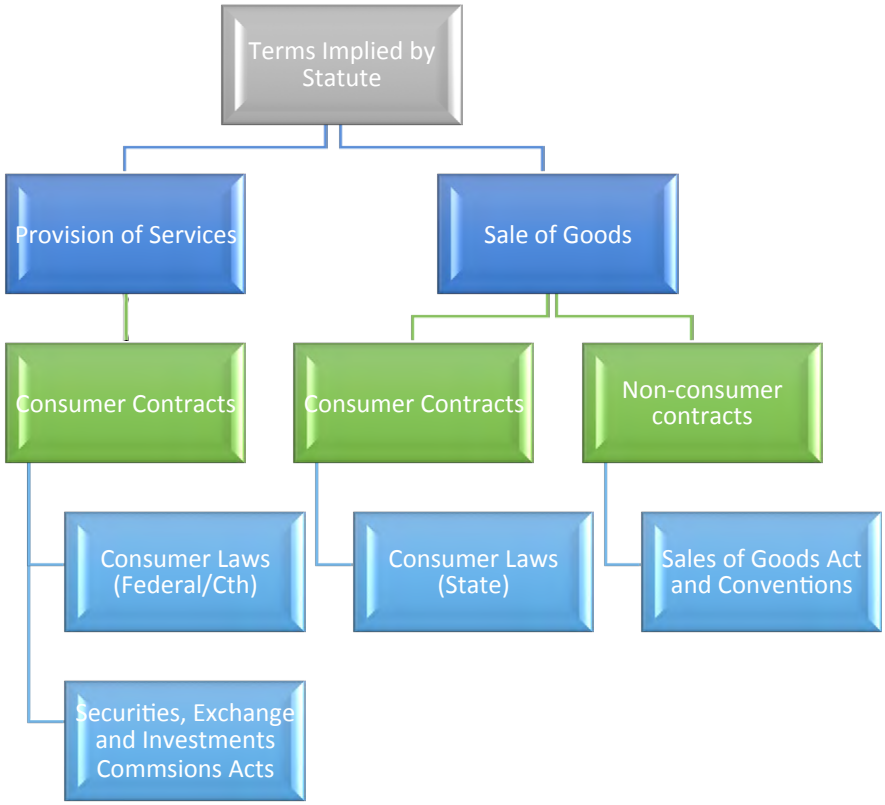


Figure 16.1 Terms Implied by Statute

The various statutes then, for consumer protection purposes, imply certain warranties and conditions into contracts for the supply of goods and services to a 'consumer' by a corporation. Generally, the implied terms relate to goods and services and concern issues such as quality, title and compliance with samples or descriptions. In summary, the implied terms apply to contracts for goods or services supplied are of a kind that is ordinarily acquired for personal, domestic or household use or consumption and are not purchased for re-supply or use in manufacturing or production. Any attempt to exclude, or limit liability for breach of, the implied terms for such personal, domestic or household goods and services is void.

However, liability for a breach of the implied terms (other than those concerning title, encumbrances and quiet possession) for goods and services which are not for personal, domestic or household goods and services can be limited to repair or replacement in the particular circumstances. Additionally, for enhanced consumer protection at a local, national and international level, corporations (main form of business entity trading internationally due to its status as an artificial legal person) from making a misleading or false representation concerning any warranty or condition that may impact adversely on the consumer the end user.

16.1.1 Statute Implied Terms

Therefore, Terms can be implied by statute into consumer *Sales of Goods Acts* of various jurisdictions and such terms are also implied by statute into *non-consumer s*ales of goods as well as into *consumer* contracts for the provision of services for enhanced consumer protection in the marketplace. These state and federal statutes imply terms into a contract and when considering the operation of these implied statutory terms, it is necessary to take into consideration the extent to which the parties may be able to alter or exclude them in their contracts.

Generally, these statutes as well as conventions such as the *Vienna Sales Convention*, in their stated provisions actually imply terms into a contract by the operation of that particular statute. Statute law even though it sits side by side with common law actually supplement each other to promote protection for consumer and in the event of a clash between statute law and common law, the statute law will prevail and overrides the common law. Thus, as statute law can override common which allows the parties to determine their own terms, it can imply terms into the contract to which the parties have not genuinely or freely consented or agreed to at the time of making the contract.

For example, in some situations terms readily implied are those terms which automatically give direct rights to consumers in relation to title, correspondence with description, merchantable quality and fitness for purpose in respect to goods that have purchased. Accordingly, terms that may be implied by statute into non-consumer 'sales of goods' include the following:

- correspondence with description – which implies a term that goods sold by description must correspond with that description;
- fitness for specified purpose – implies a term that goods must be reasonably fit for the purpose for which they were bought provided that purpose was made known to the seller and the buyer relied on the seller's skill; and
- acceptable merchantable quality – implies a term that goods must be of merchantable quality.

16.1.2 Remedies for Breach

The remedies that are available for breach of these statutory implied terms are termination of contract and/or damages. However, once the goods have been accepted, the innocent party can only sue for damages. Terms may be implied into *consumer* 'sales of goods' and the equivalent provisions of the consumer protection laws of the particular jurisdictions (if any) and these provisions are beyond the scope of this module.

16.1.3 Benefits of Statute Implied Terms

Accordingly, for fair transactions and consumer protection, terms (warranties) may be implied into *consumer* 'contract for services' and generally such provisions operate to ensure that:

- services will be carried out with due care and skill;
- any goods supplied with the service must be fit for the purpose for which they are required;
- where the buyer makes known to the service provider the purpose for which the service is required the service must be reasonably fit for that purpose; and
- certain service contracts are excluded from the operation such as:
  - o Transport contracts provided in the course of the buyer's business.
  - o Storage services provided in the course of the buyer's business.
  - o Services provided under an insurance contract.

16.2 Implied Term as to Title

In every contract for the supply of goods by a corporation to a consumer general sale of goods legislation applies to protect the consumer and ultimate purchaser of the goods and thus there is general implied condition that the seller:

- has the right to sell the goods in the case of a sale; or
- in the case of an agreement to sell, will have the right to sell the goods when the time comes for buyer to become the owner, that is, by the time property is to pass.

This implied condition amounts to a guarantee wherein the main purpose of a contract for the sale of goods is to transfer of ownership to the buyer. However, if the seller does not have title or ownership of the goods being sold then there has been a total failure of consideration and no sales of contract has been entered into.

16.3 Correspondence with Description

Where goods are sold by description, there are implied conditions that:

- the goods shall correspond with the description and this section applies where the buyer has not seen the goods and is relying on the seller's description.
- If the sale is by sample as well as description, the bulk of the goods must correspond with both sample and description.

The general principles of consumer law provides that where a contract is for the supply of goods by a corporation or other business in the course of a business to a consumer by description, then there is an implied condition that the goods that have been bought will actually correspond with the description.

This specifically applies in situations where the buyer has not seen the goods that were actually bought but has relied on the seller's description. A sale by description generally arises where the consumer selects goods on the basis of the description of the goods or the consumer agrees to purchase the goods to be made according to specific instructions and relies on the seller's skill, expertise and judgment. Thus, if goods are bought by sale by description and they do not correspond with that particular description then there is a breach of the implied condition of sale by description.

16.4 Fitness for Specific Purpose

There is an implied condition that where the buyer expressly or by implication makes known to the seller the particular purpose for which are required, and show that there is a reliance upon the judgment and skill of the seller the goods must be reasonably for the purpose. For this implied condition to operate certain conditions must first be fulfilled such as the buyer must expressly or by implication make know to the seller the particular purpose for which the goods are required at the time of negotiations and also, the buyer must have shown there was reliance on the judgment and skill of the seller and damages can be sought if the statement relied upon was made recklessly or negligently.

Thus, in circumstances where a corporation or manufacturer (the seller), supplies goods to a consumer in the course of a business and the consumer expressly or by implication makes known to the corporation, such as a manufacturer or builder, the particular purpose for which the goods are being acquired there is an implied condition that the goods supplied will be reasonably fit for that specific and particular purpose. The condition that the goods purchased are fit the purpose is generally implied where the circumstances clearly show that the consumer relied on the sellers skill and judgment and that the goods must be of a description which it is in the normal course of the sellers business to supply.

16.5 Acceptable Merchantable Quality

In respect to the common law and statutory implied term of merchantable quality in respect to sale of goods contracts for manufactured products there are generally two implied conditions:

- that which deals with goods bought by description must be of the same description; and
- that which deals with sale by sample.

In this regard there is also common law principles embedded in some jurisdictions in statute law that provides that, where a corporation supplies goods to a consumer in the normal course of its business, there is an implied condition that the goods that have been bought by the buyer, and supplied to the buyer are of merchantable quality. In this context, of implied conditions, it should be highlighted that there is no specific requirement at law as such, that goods are to be of merchantable quality in a situation where:

- the defects are actually drawn to the attention of the consumer or purchaser before the contract is actually made; or
- the consumer has examined the goods before the contract is made and the defects should have been obvious upon inspection.

In situations where no such defects are obvious or apparent, then the implied condition as to merchantable quality will directly apply, however, if a buyer is unable to detect a defect at the time of purchase and an inspection did not make the defect apparent then any relevant consumer protection law shall apply in that situation. It should also be noted that, if the description in the contract was so general that the goods sold under the contract could normally be used for several purposes, then the goods would be deemed to be of acceptable merchantable quality under that description if they were fit for any other particular purpose. However, if the description is so limited that the goods sold under the contract could be used for one purpose only, then the good would be not of merchantable and accepted quality if they were not useful for that particular purpose for which it was bought.

16.6 Business Efficacy and Implied Terms

In determining the approach that the courts will take in ascertaining and implying terms into various business and commercial contracts for 'business efficacy', it should be emphasised that the approach taken will vary depending on the particular jurisdiction. However, a general approach would include ascertaining if the contract is a 'consumer' contract for the purposes of consumer protection law. Generally, if the transaction is not a 'consumer transaction' then it does not fall within the definition that it is not a consumer contract and the provisions will not apply.

However, if the transaction is captured by a specific section of any relevant consumer protection law, then it is necessary to determine whether or not the supplier is a corporation. If the supplier is a corporation, then both the common law principles of sales of goods as well as other relevant statutes in respect to consumer protection and offering of remedies shall will apply.

It is necessary to ascertain in the circumstances of the transaction if any or all of the terms implied by any relevant sale of goods statutes and consumer law statutes have been excluded by the parties. It should be noted that generally these exclusions are not permitted as they tend to lead to an imbalance if the equal bargaining positon of the parties to the sales of goods contract as well as unfair or unjust contracts. Notwithstanding, if the terms have been effectively excluded by express agreement between the parties then there is no need to continue with the determination of which implied terms have been excluded.

However, if the implied terms have not been excluded then it is necessary to ascertain and examine the existence of the sales of goods contract in light of the following relevant implied terms:-

- Title;
- Conformity with description;
- Fitness for prescribed purpose;
- Merchantable and acceptable quality; and
- Correspondence with sample

If any of these general implied terms by statutes in contracts for the sale of goods by suppliers or manufactures have been breached, then it is necessary to determine the remedies that will be available to the innocent party or parties. Essentially, these will be contractual remedies for breach of contract, the nature of which will depend on whether the term breached a 'condition' or a 'warranty' as is illustrated by Figure 17.3 Terms Implied by Statute and Sales of Goods Legislation.

Figure 16.3 Terms Implied by Statute under Sale of Goods Legislation

Key Points

The key points in this module are:

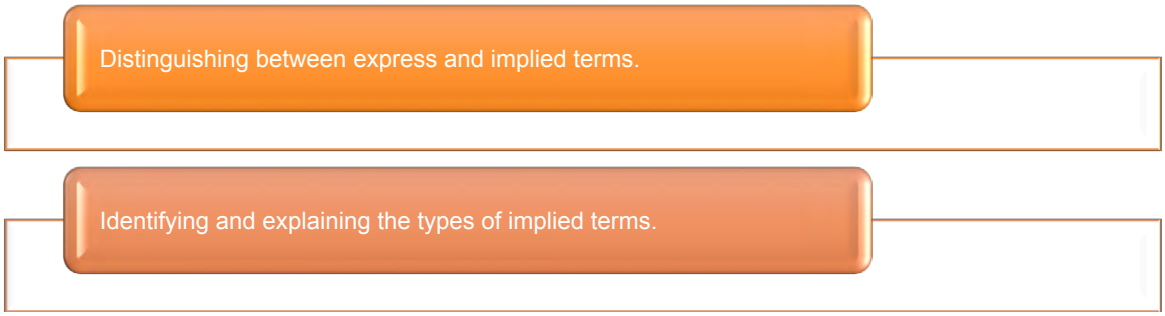
MO1: **Distinguishing between common law implied terms and terms implied by statute:** A contract in addition to express terms will contain terms implied at common law and by statute. Generally terms are implied under principles of the common law where there is an established custom or practice and it could be assumed that the parties must have contracted with that term in mind; whereas terms implied by statute are those that reinforce the protection of weaker parties to the contract and ensuring that the jurisdiction of the courts cannot be excluded.

MO2: **Explaining the importance of implied terms by statute:** Certain statutes imply terms into certain contracts especially consumer contracts guaranteeing the merchantable quality and fitness for purpose of goods and services in the marketplace.

Module 17 Sale of Goods

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Agreement to sell: occurs where the property in the goods is to be transferred at some later date, or when some conditional has to be fulfilled and agreed upon by both of the parties.

Chattels: refer to things which the law deems to be personal property.

Goods: are generally defined, to include all 'chattels personal other than things in action and money'. This normally includes only physical and movable things, ownership of which transfers to the buyer for a money consideration called the price.

Nemo dat quod non habet rule: this mean that when a person acquires good (such as a buyer), they only get the same rights to the goods as the person from whom they tool then (such as the seller).

Possession of goods: refers to the control or custody of goods.

Property in goods: refers to the ownership of, or title to, actual goods.

Sale of Goods: ownership (or property) transfers from the seller to the buyer at the time of contract.

Sale of Goods

There are a number of formalities attached to the formation of a contract of sale of goods and the effect of transfer of the goods and ownership in those goods. There is an inherent difference between 'property' in goods and 'possession' of goods that both consumers and business take into account in respect to sale of goods contracts. It is necessary to make this distinction because risk in goods passes with the property and for the sale of goods legislation to actually operate, property or ownership in the goods must pass to the buyer. Essentially in a sale of goods it is necessary that a seller has good title in the goods as a seller who does not good title cannot pass anything on to a buyer except in limited circumstances. The sales of goods legislation was enacted for the purpose of guiding the sale of goods in the market place and in today's globalised world, their effects are wider, often transcend legal and geographical boundaries for enhanced consumer protection. Nowadays, the regulation of the sales of goods is generally governed by the relevant legislation and additionally, to the these statutes there are a number of other international treaties and conventions dealing with consumers and consumer-type contracts for the sale of goods and services such as the *Fair Trading Acts*, *Consumer Protection Acts* as well as the *Vienna Convention for the International Sales of Goods* (CISG).

17.1 Sale of Goods Legislation

The *Sales of Goods* legislation applies to all contracts involving the sale of goods commercially or for everyday use. A contract for the sale of goods is a contract where a seller transfers or agrees to transfer their ownership (title) in the goods or property subject to the sale is transferred from the seller to the buyer at the time of the contract. In respect to a sale of goods contract, the definition of a good is very wide and captures many products and things.

17.1.1 Meaning of Goods

The term 'goods' under a sale of goods contract includes most forms of movable personal property of any nature or description, and essentially is often referred to as merchandise. This definition of a good recognises the fact that the goods are used in business, trade and commerce and that they may require transport and delivery from one place to another. The goods that are the subject of a sales of goods contract are generally classified as existing goods, future goods, specific goods or ascertained goods and unascertained goods.

These types of transaction are controlled by similar *Sale of Goods legislation* of the various jurisdictions. The various sales of goods legislation of the jurisdiction will normally apply to the sales transaction when the 'ownership' of the goods is immediately transferred (passed) from the seller to the buyer for money consideration (the price) thus giving rise to the sale of goods contract. If there is no money consideration present, then there is no sale of goods contract and then any sale of goods legislation does not apply and in this instance, there is a swap, barter or exchange of the specific goods. Thus the various sales of goods legislation primary function is to provide protection to consumers who purchase goods in the form of implied conditions as to correspondence with description, fitness for purpose, merchantable quality, sale by sample and title.

17.1.2 Exclusion of Implied Terms

This sales of goods legislation generally operates to allow sellers and suppliers of goods in the local, national and global marketplace to exclude the implied terms that the Acts provide. The use of exclusion clauses were used to limit or exclude the liability of sellers thereby exposing buyers to the possible risk that the goods supplied could be faulty and the buyer would have no legal remedy under the common law.

However, various amendments that have been made to sales of goods and faire trading legislation now provide enhanced and additional protection in contracts that are described as consumer contracts. The sales of goods legislation generally only apply to contracts for the sale of goods and there is no maximum value attached to the contract and it applies to not only consumers but to buyers and corporations as well. In contrast to the implied conditions and warranties under any sale of goods legislation can be excluded or the liability of the seller can be limited by certain stipulated terms of the contract.

17.1.3 Consumer Protection

A number of provisions of each sale of goods, including implied terms in a contract of sale, are reflected in the legislation to afford enhance protection to consumers under contracts for sale of goods. It is not permitted under the Act for consumers to give up or waive their rights under the Act or for sellers to exclude them. This is because of the fact that the main role and function of the Act is to provide consumers with remedies in the event that an implied term under the Act has been breached which may allow the consumer to rescind the contract.

The various sales of goods legislation is respect to trade and commerce is intended to operate concurrently with the general laws of each of jurisdiction and this is expressly stated within any of their trade practices legislation and convention in order to ensure the effective operation of the laws for the benefit of consumers in the market place. Also in this regard these diverse common law principles and statute laws apply within the nowadays global marketplace and they apply only to goods that are supplied by a corporation as its business operations can transcend legal and geographical borders in its trade practices at local, national and international level.

Another reason for this distinction between business entities, is that the provisions of the trade practices, sales of goods and consumer protection including the implied terms, do not apply to goods and services that are supplied by a sole trader, partnership or other unincorporated body but only applies to incorporated bodies such as corporations (artificial legal person). Despite this difference, at times the application of these general sales of goods, trade and consumer protection laws, including the implied terms, are in some situations extended subject to approval to directly to sales of goods and services by traders, including individual and other entities that are engaged in interstate and international trade and commerce, overseas trade or the supply of goods and services however defined.

17.2 Possession and Property of Goods

Under sales of goods legislation, 'possession' of goods refers to the control or custody of goods and the 'property' in goods actually refers to the ownership of, or title to the goods. It should be noted that under a sales of goods contract there are different formalities attached to them due to the effect of the transfer of the goods upon payment of money consideration the price and ownership. Accordingly, there is a difference between 'property' in goods and 'possession' of goods that both business and consumers must be fully aware of especially in the international global market.

The primary reason for this is because of the associated risk and ascertaining which it passed with property and for the sale of goods legislation to effectively operate, property or ownership of the goods must actually pass to the buyer. In this context it should be mentioned that a seller must actually a good title at the time of sale, in order to pass it on to the buyer and if this is not the case say if a good is stolen the buyer does not get good title. Therefore, under the *nemo dat quod non habet rule* when a person acquires goods (such as a buyer), they only get the same rights to the goods as the person from whom they took the goods (such as the seller). Thus, if a seller does not have good title he cannot pass anything on to a buyer under the purported contract for sale of goods.

17.3 The Vienna Sales Convention

The *United Nations Convention on Contracts for the International Sale of Goods* 1980 (often referred to as the CISG) is known as the *Vienna Sales Convention* and came into force at an international level on 1 January 1988. The *Vienna Sales Convention* is significant in the international global market as it regulates contracts for sale of goods, entered into between the parties whose places of business are in other signatory countries.

The primary purpose of the *Vienna Convention* is the provision of a uniform sales of goods code that regulates international sale of goods including formation of the contract, rights and duties of the buyer and seller as well as the remedies that are available to an injured or aggrieved party for breach of a fundamental term of the sales of goods contract. It should be noted that contracting parties in different signatory states are able to exclude or vary the operation of the *Vienna Convention* to suit their particular contractual circumstances.

17.4 Definition of Consumer

In general terms a consumer is defined as a person who acquired goods or services for personal or household use according to the definition as embedded in common law principles and relevant statutes. Most consumer dealings and contracts that take place in the marketplace in commerce or business are fundamentally based on common law principles and law of contract.

The inherent assumption that is at the core of the common law rules of contact is that the bargain was freely entered generally into between equal bargaining parties. However, this assumption cannot always operate well in some sales of goods contracts because most consumer goods are manufactured, marketed and sold by large corporations that operate on a global scale. In today's globalised marketplace, most jurisdictions have acknowledged the fact that the consumers do not have the same knowledge, expertise, advice and resources as large business corporations and entities when entering into sales of goods contracts and therefore require protection.

Therefore many jurisdictions introduced laws that are designed to protect consumers from unscrupulous traders as well as unfair and unconscionable conduct and business practices at all levels in the marketplace whether conducted faced to face or on line via e-commerce. In recent times, in light of the importance of consumer protection in respect to sales of goods contracts some organisations have adopted codes of conduct and practice which are designed to reduce unfair practices and to help consumers be aware of their rights and to take effective remedial action depending on the circumstances. Contract law determines disputes between consumers and traders, while legislation enacted by the parliaments create rights for consumers in relation to defective goods, misleading statements releasing to goods and services and unfair practices by traders and manufacturers.

17.5 Fair Trading Acts

Prior to the constitutional limitations that were placed on various trade and fair trading legislation the laws to govern and protect consumers within the marketplace have been elevated to enhanced consumer protection provisions under the various jurisdiction and courts as well as enhanced consumer protection through international treaties, and conventions such as the *Vienna Convention for International Sales of Goods*. The main features of general consumer and fair trading legislation is that they contain important provisions that prohibit misleading and deceptive conduct and unconscionable conduct, false representations and other unfair practices in the marketplace and are directed at corporations and other business entities. Additionally, each of the jurisdictions in the marketplace, generally make provisions for implied terms as well as duties in relation to the provision of services in the marketplace.

Key Points

The key points in this module are:

MO1: **Distinguishing between a sale of goods and a contract for work done and materials supplied:** A contract for the sale of goods is a contract whereby the seller transfers or agrees to transfer ownership of goods to the buyer for a money consideration known as the price. A contract for the sale of goods is distinguished from a contract for work done and materials supplied (labour and materials) by considering the main purpose of the contract. If the main purpose of the agreement is the skill and experience to be displayed by one of the parties in performance of the contract, and the transfer of title to the materials is of secondary importance, then it is a contract for work and labour and the supply of materials. These contracts are basically a hire of skill, and delivery of the item is secondary. The item is merely a means for demonstrating the skill.

MO2: **Explaining the importance of sales of goods legislation at state and international levels:** Where there is a sale of goods at state and international levels, any local/domestic and international legislation and sales treaties and conventions operates to assist with the effective transfer of, ownership (or property) from the seller to the buyer at the time of the contract is entered into.

MO3: **Explaining the rules of when ownership passes from the buyer to the seller:** Ownership passes from the buyer to the sell at the time that the consideration (price) for the goods is made and satisfied. There must be a transfer of ownership (or property) on the goods if the transaction is to be caught by sales of goods legislation. The importance of transfer of ownership is that risk of loss of the goods goes with the person who has the ownership of the goods.

Module 18 Operation of Sale of Goods Acts

Module Objectives

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

- Distinguish between a sale of goods and a contract for work done and materials supplied.
- Define and distinghuish between the different classificaitons of goods.
- Explain the rules of as to when a transferee does not have good title under a sales of goods.
- Explain the duties of the seller and the buyer under a sales of goods.

Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Agreement to sell: occurs where the property in the goods is to be transferred at some later date, or when some conditional has to be fulfilled and agreed upon by both of the parties.

Nemo dat quod non habet rule: this mean that when a person acquires good (such as a buyer), they only get the same rights to the goods as the person from whom they tool then (such as the seller).

Possession of goods: refers to the control or custody of goods.

Property in goods: refers to the ownership of, or title to, actual goods.

Sale of Goods: ownership (or property) transfers from the seller to the buyer at the time of contract.

Operation of Sale of Goods Acts

The sale of goods legislation operates to provide some measure of protection to consumers and apply to a contract for the sale of goods and services whether locally, nationally or internationally. To determine whether a transaction falls under the sale of goods legislation of any jurisdiction operating in the marketplace, it is necessary to be able to determine if a contract is for the sale of goods, which means that the sale of goods legislation will apply, or merely for work and materials or repair, in which case the *Sale of Goods Act* will not apply and the buyer will have to rely on contract law for any remedies. A contract of sale includes a sale of goods and an agreement to sell.

In respect to these two types of contract is important in terms of the rights and obligations under them. A contract for sale of goods is often referred to as an executed contract while an agreement to sell is referred to as an executory contract. These two types of contracts for the sale of goods and services are generally defined in the various sale of goods legislation. However, the distinction is not clear cut because some contracts often involve both an element of service and an element of goods which means that the Court will have to determine if the main purpose of the agreement is to transfer ownership in the goods and if this is the case then the transaction is a contract for the sale of goods to which the law shall apply at both the common law and statute law as appropriate.

18.1 Formation of Sales of Goods Contracts

A contract for the sale of goods is generally defined in the sales of goods legislation as a contract whereby the seller transfers or agrees to transfer, the actual property in the goods to the purchaser, a consumer as defined under the legislation and hence its ownership for a money consideration called the price. In order for the sale of goods legislation to apply it is necessary that there has been an actual purchase of goods which are broadly defined and consist of different classifications for money consideration called the price and an actual and immediate transfer of ownership of the property that is subject to the sales contract. The term goods includes most forms of movable (tangible) personal property commonly referred to as merchandise of which there are four categories existing goods, future goods, specific goods and unascertained goods that are the subject of contracts of sales on a daily basis in trade or commerce and that are easily transported from the seller to the buyer.

18.2 Consideration for Sale of Goods

Under contract law an essential rule is that for a contract to be formed and enforced that valuable consideration must pass between the parties and this fundamental rule of contract law is also relevant and applies to the sale of goods. Generally, the sale of goods legislation provides that consideration in the form of money must exist in order for a contract of sale to be valid. If goods are provided free of charge or are transferred through an exchange, barter or swap then then the sales of goods acts do not apply as there was no consideration (price paid) to support the sale transaction. In this context, the term 'price' refers to the cost or charge to purchase the goods and generally the price paid for goods when that the purchaser (consumer) has acquired possession and good tile to that good and has ownership or property in the good purchased that was subject to the initial sale of goods contract.

Thus under the sale of goods contract, the price that is paid for the goods is the money consideration, and as such, if there is no money consideration present, then there is no sale of goods contract and the sale of goods legislation does not apply and in this instance, there is a swap, barter or exchange of the specific goods. If there are situations where no actual price for the goods have been agreed upon by the parties, then the buyer must pay a reasonable price and this is a question of fact in each case.

18.3 Transfer of Property

Transfer of property or ownership means that the ownership in the goods is transferred at the time of the contract of sale and is formed when a good is bought by the purchaser form the seller and is transferred upon the payment of the price being the consideration. If the transaction is to be caught by the respective sale of goods legislation then there must be an actual transfer of ownership (or property). Effectively this means that at general law, when a good is bought ownership passes from the seller to the buyer and the sales of goods legislation effectively provides indicators that determine at what point goods are transferred from the seller to the buyer where the intention of the parties in this instance is lacking, unclear or not satisfied for whatever reason.

In contracts of sale the actual intention of the parties regarding when the property (and the associated risk) is to pass from the seller to the buyer is a very important and crucial matter that needs to be determined by the courts in any given circumstance regarding a sales of goods contract involving a dispute between the seller and the buyer. In respect to the buying and selling of goods the general principle of contract law apply. Generally if the goods are purchased by persons with limited capacity such as minors, and they are for necessaries then they must pay a reasonable price for the goods. The importance of transfer of ownership is that risk of loss of the goods passes with the person who has the ownership of the goods.

18.4 Definition of Goods

The sale of goods legislation and *Vienna Sales Convention* generally provides a definition of 'goods'. In respect to a general law definition, 'goods' includes all chattels personal other than things in action and money. This definition of goods only includes and captures a wide range of items and products that are physical and movable but does not include land or any interest in land, shares or debentures or services such as work, labour or repair. There are a number of classifications of goods and include existing goods, future goods, specific or ascertained goods and unascertained goods.

Goods that are the subject of sales of goods contract are classified under the sale of goods legislation as: existing goods, future goods, specific or ascertained goods and unascertained goods. Even though there are at often some significant overlap. However, this distinct classification is important especially for the purpose of determining when the property and the actual risk of the loss of the goods passes to the buyer (consumer). The classification of goods that are the subject matter of the sale of goods contracts includes:

- existing goods – is the term used to refer to goods that are owned and possessed by the seller at the time that the contract was made;
- future goods – is the term used to describe those goods that are manufactured or acquired by the seller after the contract of sale has been made;
- specific or ascertained goods – these are identifiable goods in a contract for specific goods that have actually become identified and agreed upon by the parties; and
- unascertained goods – goods that cannot be identified with any certainty or agreed upon at the time the contract of sale was made.

18.5 Agreement to Sell and Sale

The main distinguishing feature of an agreement to sell (executor contract) and an actual sale (executed contract) is that ownership or property in the goods has not yet passed to the buyer. Generally, any property or ownership in property or the goods is transferred when the goods bought under the sale of goods contract is actually delivered to the buyer. In respect to an agreement to sell, the goods remain the property of the seller until the time of delivery has arrived and the buyer has actually accepted the goods, or the conditions subject to which the property is to pass to the purchaser are fulfilled.

The importance of the distinction between a sale and an agreement has a different effect on the parties depending on whether it is a sale or merely an agreement to sell in terms of the rights and obligations attached to the agreement and the time at which ownership or transfer of the goods or property occurs with a corresponding passing of the property and hence the risk in the goods or property. The definition of a 'contract for the sale of goods' includes two types of contract:

- a sale of goods where ownership (or property) transfers from the seller to the buyer at the time of the contract, and has actually been finalised and is executed; and
- an agreement to sell where the property in the goods is to take place at a future date or when some specific condition has been fulfilled, such as upon the payment of the stipulated price, and when this occurs the contract has yet to be finalised and is executory.

18.6 Executed Sale of Goods Contract

A sale (executed contract) arises when an actual sale of goods takes place and where the ownership of the goods is transferred from the seller to the buyer (consumer) at the time the contract is made. Under a sale, being an executed sale of goods contract, it gives the seller the right to sue the buyer (consumer) for the price of the goods if they still remain unpaid, provided however that the goods have been delivered to the buyer. In respect to the rights of the buyer, an executed sale of goods contract gives the buyer (consumer) remedies for any breach and the right to claim damages against the seller if the goods are not transferred, as well as for interference with the goods, that is, if the seller commits a breach such as wrongfully disposing of the buyer's goods acquired under the sale. In respect to the passing of the risk, an executed contract stipulates that after the sale of goods contract has been concluded, then the buyer bears the risk of loss in respect to the goods.

18.7 Executory Sales of Goods Contract

An agreement to sell (executory sales of goods contract) arises when ownership of the goods is to be transferred at a future time or subject to a future condition and generally arises where an agreement to sell involving, unascertained goods has been formed. An agreement to sell (executory sales of goods contract) does not involve the transfer of the unascertained goods at the time that the contract is made but at a later future time, when it then becomes a formal sale, or the transfer of the goods depends on the performance of a stipulated condition in the contract.

An executory sale of goods contract may involve an agreement to sell which then becomes a sale when the goods are actually delivered or the stipulated condition is fulfilled. In respect to the passing of the property and hence the risk in the property under an agreement to sell (executory sales of goods contract) the risk in the goods remains with the seller because actual ownership of the goods has not yet been transferred to the buyer. In the event of a breach by the buyer for non-payment of the price under an agreement to sell (executory sales of goods contract) the seller cane sue the buyer and conversely the buyer can sell the seller for non-delivery of the goods purchased under the contract. Under an agreement to sell as distinct to a sale, ownership or property in the goods has not yet passed to the buyer and the goods remain the property of the seller until the time of delivery and the buyer has accepted the goods or any conditions to which the property is subject to are totally fulfilled.

Even though under an agreement to sell (executory sale of goods contract) the property has not yet passed to the buyer, it is still treated as a 'contract for sale' for the purposes of the sale of goods legislation. The main reason for this is that a contract is broadly defined under the sale of goods legislation, and the Acts are intended to regulate all contracts that involve an actual sale of goods regardless of whether or not delivery of the goods purchased by the buyer has taken place by the seller.

18.8 Passing of Property

People who possess goods are not necessarily the true owner of those goods in their possession and may holding them temporarily such as in a bailment. A person who has possession of goods simply has the physical control of the goods or custody of the goods and hence possession is only temporary. When a good is bought, ownership passes from the seller to the buyer, general law provisions generally determine at what point goods are actually transferred from the seller to the buyer where the actual intention of the parties is lacking or not evident. Thus, in order to assist the court in determining the intention of the parties regarding when the property passes from the seller to the buyer it is important that the actual sales contract can be identified, and in this instance the sales of goods legislation provide various 'rules' such as ownership, possession among others in order to assist with this determination of intention which is a crucial element of a valid sales of goods contract between the parties.

Essentially in applying those rules the courts will generally look at the contract as a whole, the conduct of the parties and the individual circumstances surrounding the contract in order to establish when the actual transfer of title has taken place. In a sales of goods contract, in most cases property (ownership) in the goods passes with delivery, from the seller to the buyer. This means that once the goods have been delivered by the seller to the buyer the actual ownership and risk in the goods has effectively passed from the seller to the buyer, which is the general rule under the common law.

However the sales of goods legislation make specific provision for the passing of property in relation to the sale of goods. This is because unlike the common law, the general sales of goods legislation actually distinguishes between two types of contracts that involve the sale of goods, namely:

- specific or ascertained goods – these are identifiable goods in a contract for specific goods that have actually become identified and agreed upon by the parties; and
- unascertained goods – goods that cannot be identified with any certainty or agreed upon at the time the contract of sale was made.

18.8.1 Transfer of Title

Title refers to legal ownership of property and generally a person receives good title if the person (owner of the goods) from whom they received ownership of the goods has good title, and if not then the buyer does not receive good title in the goods. A buyer generally receives the same rights to the goods as the ones possessed by the seller (when he or she is the true owner) and this is called the *nemo dat rule quod non habet* rule which means that "A person cannot pass on that which he/she does not have".

The *nemo dat rule* states that if goods are sold by a person who is not the true owner, and does not sell them with expressed or implied authority or with the consent of the true owner, then the buyer does not acquire a better title to the goods then the seller had. This means that the buyer of the goods from the non-owner or true owner cannot receive a better title than the seller. If the goods have been taken from the true owner than he/she is entitled to recover them.

18.8.2 Exceptions to the nemo date rule

However, there are certain exceptions to the *nemo dat rule* permitted by the sale of goods legislation and include:

- market overt – refers to the situation where goods are bought in a public market that is usually regulated by local council.
- estoppel – in the context of a contract for sale is used to stop or prevent the owner from claiming the goods back if the innocent party has paid for the goods;
- sale under voidable title – a contract of sale is deemed voidable in some situations such as lack of genuine consent, duress or undue influence, mistaken identity of misrepresentation;
- seller is in possession of goods but sells them to a third party – where a third party makes a purchase in good faith and lacks knowledge of the previous sale, then the third part, that is the second buyer, receives good title;
- buyer in possession – means that the buyer can pass on good title to the third party if third party has acted in good faith and did not receive notice of the defective title;
- factors or mercantile agents – a factor or mercantile agent is a person who is authorised to act as an agent and to sell goods, consign goods for the purpose of sale, buy goods, or raise money on security of goods.

18.9 Performance of Sales of Goods Contract

In order to complete a contract for sales of goods in the marketplace, the seller must deliver or give possession of the goods to the buyer and the buyer must be ready to accept the goods and to pay for them in accordance with the stipulated terms of the contract. Once the goods have been purchased under the relevant sales of goods legislation and all of the terms of the contract have been complied with, then delivery takes place where there is an actual and immediate transfer of possession and ownership in the goods from the seller to the buyer. In respect to the performance of the terms of the contact as stipulated under sales of goods legislation there are a number of duties of the seller and the buyer in respect to the goods purchased.

18.10 Duties of Seller and Buyer

Under the sale of goods legislation, the performance of the sales of good contract occurs upon the actual transfer of possession of the purchased item for the consideration (price) and it is then deemed to be completely performed by both parties and is discharged. The seller and the buyer have a number of duties that must be complied with satisfactorily in order for the sales contract to be completely performed and discharged. The general sales of goods legislation, set out a number of general rules as to delivery of the goods purchased by the buyer and they will apply if the contract between the parties does not state anything to the contrary.

There are a number of general duties of the seller in respect to delivery of goods and include among others expense and cost of delivery, place of delivery and time of delivery. In respect to the duties of the buyer, the sales of goods legislation normally stipulate that the duty of the buyer is to accept the goods and pay for them when they are delivered by the buyer in accordance with the stipulated terms of the contract. Acceptance by the buyer in the context of sale of goods refers to performance of the contract and the transfer of ownership and hence property in the goods. A buyer under the sale of goods legislation will be deemed to have accepted the goods when the buyer has informed the seller of his acceptance, if the buyer has performed any act that is inconsistent with the ownership of the seller such as consumption of the goods, or the buyer still has possession of the goods after a reasonable time without advising the seller that the goods have been rejected. If any of these duties of the seller and buyer are breached than the innocent party either the seller or the buyer has remedies available under the respective sales of goods and consumer protection legislation.

18.10.1 Duties of the Seller

Upon the satisfactory completion of a contract of sale the seller must be ready to deliver, give, transfer or assign possession of the goods that have been purchased to the buyer which is illustrated by Table 18.1 Duties of the Seller under a Sales of Goods Contract. Such delivery takes place when the seller voluntarily transfers (assigns) possession of the goods to the buyer. In respect to such transfer or assignment the duty of the seller is to actually deliver the goods to the buyer in accordance with the general rules that are applied in ascertaining if intention was present in the sales of goods contract in the given circumstances.

Aspects Relating to Sellers Duties	Specific Duty of Seller
Expenses	The seller is responsible for the cost of preparing the goods for delivery
Place of delivery	Unless otherwise agreed, the seller is obliged to deliver the goods to the buyer's place or location.
Delivery involving a carrier	The carrier must be able to confirm or ascertain that the goods are held on the buyer's behalf.
Time	Where a date and time has not been set for delivery, the seller is obliged to deliver the goods within a reasonable time. This is dependent upon the nature and type of goods, such as for instance in respect to perishable goods delivery is generally must faster and immediate.
Quantity	The seller is obliged to deliver the quantity of goods ordered by the buyer or agent.
Delivery by instalments	Unless other arrangements have been made, the buyer is not obliged to accept delivery of the goods by instalments.

Table 18.1 Duties of the Seller under a Sales of Goods Contract

18.10.2 Duties of the Buyer

When the seller has satisfactorily completed their specified duties as stated under the sales of goods legislation and the seller has delivered the goods to the buyer in a satisfactory condition the buyer have certain duties as is illustrated by Table 18.2. Duties of the Buyer under a Sales of Goods Contract. If the goods purchased are delivered by the seller in good condition that is, not damaged or defective in any manner and generally fit for the purpose and of merchantable quality it is the buyers duty to accept the goods that have been bought and delivered from the seller and if payment has not occurred, to fully pay for the purchased goods in accordance with the specific terms of the sales of goods contract.

Aspects Relating to the Buyer's Duties	Duty of the Buyer
Acceptance	The buyer may communicate acceptance by notifying the seller in seller in express terms that they have accepted the goods, or the buyer may indicate through terms that have been implied, that is through past or prior dealings, conduct and behaviour, such as keeping the accepted the goods for more than a reasonable period of time.
Rejection of Goods	The buyer must notify the seller that he/she has rejected the goods and this may take place in situations where the goods are defective or non-compliant with the terms of the contract.
Make full payment	The buyer must pay the agreed price upon the formation of the contract and if the does not state the price, then the buyer is able to pay a reasonable price for the goods and payment must be made immediately upon delivery of the goods unless prior payment arrangements have been agreed to between the seller and the buyer.

Table 18.2 Duties of the Buyer under a Sales of Goods Contract

18.11 Remedies for Breach of Contract

A person who has sold that is passed property in the goods to the buyer who has not received full payment that is the price (consideration) in the form and manner agreed to between the parties such as cash, cheque or bill of exchange is called an unpaid seller. An unpaid seller may also include a person who is acting on behalf of the seller such as an Agent. The sales of goods legislation provides a number of remedies to either the seller or the buyer where there is a breach of contract by either the seller or the buyer in any particular situation.

18.11.1 Sellers Remedies

The remedies of the seller under general sales of goods legislation is as follows:

- Rights against the goods: an unpaid seller can exercise certain rights against the goods that have passed to the buyer and even if the property in the goods has not yet passed to the buyer. If the goods has not passed to the buyer the unpaid seller has four main rights:
  - The right to lien;
  - The right to withhold the goods;
  - The right to stop the goods in transit; and
  - The right to re-sell the goods.
- Rights against the buyer: an unpaid seller has certain rights as against the buyer for the price of the goods or damages for non-acceptance of the goods. Where the goods have actually passed the seller has a right against the buyer to bring an action against the buyer for the price of the goods.

18.11.2 Buyers Remedies

A buyer is the person who has purchased the goods from the seller and who has a rights against the seller in circumstances where the goods delivered were not the actual goods purchased or the goods are faulty and defective. In respect to the remedies against the seller by the buyer, who is the person who has purchased the goods from the seller, has certain rights as against the seller. The buyer has rights against the seller in a number of situations where the seller has not delivered the goods or the goods were defective.

The remedies that are available to the buyer include the right to sue for damages, the right to specific performance or the right to rescind the contract (equitable remedy of rescission). The remedies of the buyer includes the following:

- **Damages** – If the seller wrongfully voids or refuses to deliver the goods to the buyer then the buyer has the right to sue for damages in respect to the non-delivery of the goods. The actual damages awarded will be calculated on the direct and ordinary loss that flowed as a consequence of the sellers default. The damages generally awarded is the difference between the sale priced of the goods and the current market price. However, in situations where the seller has breached a warranty or the buyer has elected to treat a breach of condition as a breach of warranty, then the buyer may seek a reduction in the price that was originally asked for by the seller for the goods that were damaged. In this case damages will be the difference between the market value of the goods at the time of delivery and the value of the goods if the breach of warranty had not occurred.
- **Specific Performance**- Specific performance is generally awarded in situations where the seller has not delivered specific goods that are rare in nature and damages would not be adequate, such as a rare painting or antique.
- **Rescind (rescission)** – The buyer may be able to avail himself or herself of the equitable remedy of rescission, that is withdraw from the contract where a vital condition has been breach by the seller. If the breach relates to a total failure of consideration from the seller, the buyer may be entitled to a full refund of the purchase price.

Key Points

Module Objectives:

The key points in this module are:

MO1: Distinguishing between a sale of goods and a contract for work done and materials supplied: A contract for the sale of goods is a contract whereby the seller transfers or agrees to transfer ownership of goods to the buyer for a money consideration known as the price. A contract for the sale of goods is distinguished from a contract for work done and materials supplied (labour and materials) by considering the main purpose of the contract. If the main purpose of the agreement is the skill and experience to be displayed by one of the parties in performance of the contract, and the transfer of title to the materials is of secondary importance, then it is a contract for work and labour and the supply of materials. These contracts are basically a hire of skill, and delivery of the item is secondary. The item is merely a means for demonstrating the skill.

MO2: Defining and distinguishing between the different classifications of goods: existing goods, future goods, specific goods, unascertained goods and ascertained goods: Existing goods are goods owned or possessed by the seller at the time of the contract; Future goods are goods 'to be manufactured or acquired by the seller after the making of the contract for sale'; Specific goods are goods identified and agreed upon at the time of the contract of sale and this overlaps with the classification of 'existing goods' above; Unascertained goods are goods that are defined by description only. They are not identified when the contract is made and they may or may not be future goods. Until the goods are ascertained, it is merely an agreement to sell and until that particular car comes off the assembly line and is earmarked for the customer, the car is a future and unascertained good; and Ascertained goods are goods that, in a contract for the sale of unascertained goods, have become identified and agreed upon by the parties.

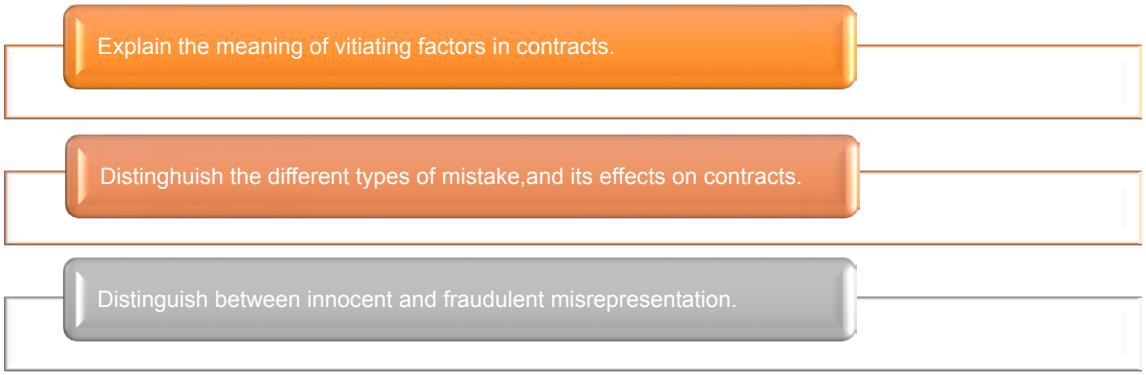
MO3: Explaining the rules as to when a transferee does not have better title than that which the transferor conveys under sale of goods: As a general rule, the buyer gets only the same title to the goods as the person from whom they obtained them and does not have a better title in cases where the goods have been stolen. This is referred to as the 'nemo dat rule' – *nemo dat quod non habet* (no one can give what they don't have).

MO4: Duties of the seller and buyer: The duties of the seller is to deliver and transfer the goods upon payment of the price (consideration) for the goods and the buyer is to pay for the goofs at point of sale or upon delivery.

Module 19 Vitiating Factors

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Misrepresentation: refers to a false statement of fact, which may be intentionally or unintentionally made rendering the contract unenforceable due to lack of consent.

Rescission: refers to an annulment of the contract making it *void ab initio* (void from the beginning).

Representation: refers to a statement of fact.

Vitiating Factors

For a contract to be valid it requires all of the elements, including the genuine consent of both parties to the transaction being negotiated. A contract that is validly formed may be avoided as a result of a number of possible 'vitiating factors' that render a contract invalid due to lack of genuine consent. Most of these involve some form of unfair of unconscionable dealing by one of the parties. The term vitiating factors, is the name given to factors that avoid, or vitiate, a contract simply because the actual and genuine consent of one party to the contract is not true or genuine. Even though an apparent simple contract appears to exist, in actual fact is that one party has not genuinely agreed or consented to being bound by the terms and conditions of the agreement being negotiated which means that no valid and legally binding contract has been formed.

In contract law if the consent of one of the party is not given freely and is not genuine, it means that it has been obtained as a result of unlawful and coercive means and was probably obtained because of a vitiating or avoiding factor. Examples of vitiating or avoiding factors include undue influence, duress, mistake, unconscionability or misrepresentation and of these different vitiating factors the most prevalent in today's business world includes unconscionable conduct, misrepresentation and misleading and deceptive conduct.

19.1 Undue Influence

In situations where undue influence, is established, it will also render a contract voidable. Undue Influence occurs when there is an inequality of power between the contracting parties and results in the weaker party entering into a contract with the dominant party usually without true or genuine consent being present. Where undue influence has been satisfactorily established, the transactions will not always result in a remedy at law. However, where the undue influence that exists between the parties can be classified as 'undue', 'unfair', 'oppressive' or coercive' and the weaker party will have the choice of rescinding the contract. Undue influence generally takes two main forms; express undue influence. This arises where the dominant party acts in such a manner that it effectively deprives the other party of their free will and this sometimes may overlap with duress and can arise where there is no special relationship. The other form of undue influence is commonly referred to as presumed undue influence which occurs where the dominant party holds a position of trust or confidence over the weaker party, for example where there is a special relationship as between a solicitor and client, where in such situations it will be presumed that the influence that existed between them when entering the contract was 'undue' or 'unjust' or 'oppressive' or coercive' unless the dominant party can prove otherwise.

19.1.1 Presumed Undue Influence

Where a contract is actually made between the parties in certain specified relationships, the law operates to presume that there was undue influence in that agreement. In these particular cases the weaker or subservient party need to only establish that the relationship existed. In these types of situations the dominant or stronger party has to establish that there was in fact no undue influence. The classes or relationships where the law actually presumes that there is undue influence are as follows:

- Parent over child;
- Solicitor over client;
- Doctor over patient;
- Trustee over beneficiary;
- Guardian over ward; and
- Religious adviser over devotee.

19.2 Duress

In situations where duress is established the common law enables the injured (innocent) party to avoid or be exempt from their contractual obligations by making the contract voidable. In order for duress to be established one of the contracting parties must exert 'illegitimate' 'unlawful' and 'coercive' pressure on the weaker party which induces the weaker party to enter into the contract. Duress refers to the person involved using unlawful behaviour such as threatening to kill the other party or harm or injure any member of their family if they do not enter into the contract, injury or harm to the property of the other person, such as threatening to burn down their house or business premises if they do not enter the contract or may take the form of 'economic' duress.

In respect to business operations, economic duress may arise and exists, for example, where the dominant party threatens not to perform a contract. It should be noted however that not all such threats will constitute duress and in particular, if other options were available to the weaker party such as purchasing the product somewhere or seeking some form of legal redress or remedies, then duress will not be established.

19.3 Mistake

The term mistake in a contract refers to the circumstances where because of an error or misunderstanding by one or both of the parties, the contract's enforceability will be adversely effected. Mistakes in contract are generally divided into classifications of mistake of fact and mistake of law. There are four main categories of mistakes of fact namely, common mistakes, mutual mistakes, unilateral mistake and *non est factum* (it is not my deed) as is illustrated by Figure 19.1 Mistake of Fact.

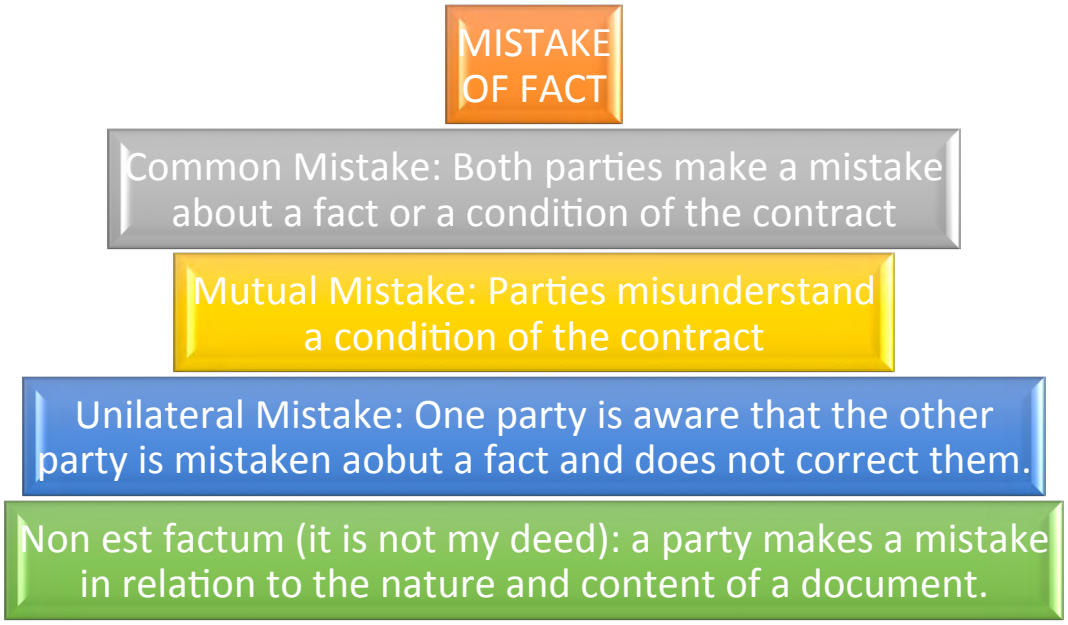


Figure 19.1 Mistake of Fact

Mistake is a complex area of contract law and often gives rise to numerous and lengthy contractual disputes in ascertaining the exact meaning and terms of a purported contracts that had been negotiated as between the parties who had different things in mind and consequently cannot be enforced due to mistake. As a general rule, if an actual mistake is made about some particular aspect, issue or term of the contract it will not necessarily provide the injured party with a right to escape or avoid contractual obligations, even if a fundamental mistake is fundamental. In contract law there are three forms of mistake that may provide contractual remedies in exceptional and limited circumstance:

- common mistake;
- mutual mistake;
- unilateral mistake; and
- *non est factum*.

19.3.1 Common Mistake

A common mistake occurs when both parties are mistaken about the same thing, for example, the authenticity of a piece of art or the existence of the subject matter of the contract. Under a common mistake only under limited circumstances will it give rise to remedies at common law due to the difficulty of ascertaining the true and actual facts surrounding the mistake. However, in such exceptional instances equity will provide some available relief and remedies to the injured or innocent party in the form of rescission, restitution or restoration.

19.3.2 Mutual Mistake

A mutual mistake arises when both parties are both or mutually mistaken as to the basis of the contract and more particularly they are mistaken but about different things. In practice this has not arisen very often and consequently legal position is unclear and not clear cut because very often where these types of such mistakes exists the agreement is said to be too vague or uncertain as to its actual terms in order for it to be enforceable without the need to rely on mistake as a separate cause of action.

19.3.3 Unilateral Mistake

In practice Unilateral mistake is more common; because it occurs when one party is mistaken about some particular and important aspect of the contract but the other is not. The common law does not readily provide remedy for unilateral mistake as it can give rise to difficulty in ascertaining the actual terms of the agreement and contract. However, to provide some form of relief or remedy Equity will intervene more frequently to assist the injured or innocent party.

In this situation however, equity requires some improper conduct on the part of the unmistaken party whereby that party seeks to prevent the other party becoming aware of the mistake. In some situations, where this is the case there will be some misleading conduct involved which will provide separate and more stricter statutory remedies. The relevant remedy where an actionable mistake exists is rescission, restitution or restoration.

19.3.4 "*This is not my Deed*" – *non est factum*

In respect to mistake and written documents the doctrine and defence of 'this is not my deed – *non est factum* will arise especially where a party signing later discovers that they had signed was not what was actually agreed to and fundamentally different to what they thought it was. *Non est factum* occurs rarely and is established where a party is mistaken about the nature of the document they are signing – essentially that, through no fault or neglect of their own they were unable to understand the meaning or the significance of the document they were signing.

19.4 Unconscionable Conduct

Unconscionable conduct deals with transactions between dominant and weaker parties; and it tends to overlap with duress and undue influence. Due to the unfairness of this type of conduct or behaviour unconscionable conduct is prohibited under the common law, equity and under statute law of jurisdictions to enhance consumer protection. In situations where there is evidence of unconscionable conduct, Equity will intervene in situations where one party has taken advantage of a 'special disability', such as age, illiteracy, lack of education or a combination of factors that are held by the other weaker and generally vulnerable party.

As a result of this unconscionable conduct or behaviour the actual transaction is normally deemed to be harsh and oppressive to the weaker party. In cases where unconscionable conduct or behaviour has been clearly established the weaker party may elect to avoid the transaction and not be bound by any obligations under it. General common law principles and legislation in legal jurisdictions operate to prohibit unconscionable conduct, such as misleading and deceptive statements and conduct and prohibit such conduct specifically in relation to consumer and small business transactions.

19.5 Rescission

Rescission is an equitable remedy, which allows an innocent party to cancel and be removed from the obligations under the contract by rescinding the contract or it there has been misrepresentation by the other party, raising the misrepresentation which probably acted as an inducement to enter into the contract, as a defence if sued for damages or specific performance by the other party. Fundamentally the purpose of rescission which is an equitable remedy is that it entitles and enables the injured party to rescind that is set aside the contract and restores the injured party to their pre-contractual position. Rescission can be granted because of mistake, misrepresentation, undue influence, duress, unconscionability and provides that a consumer is entitled to rescind a contract for the supply of goods for breach of the implied conditions as to title, correspondence with description, merchantable quality, fitness for purpose and sale by sample corresponding to those that are implied in contracts of sale under sale of goods legislation. It should be noted that for rescission to be available to the injured party, substantial restoration or rectification must be possible.

19.6 Misrepresentation

The law has for a very long time recognised the importance of proper and honest pre-contractual negotiations at the time of entering into agreement and contracts. The process of negotiation is an essential and vital part of commercial dealings and the law at common law, equity and statute law strives to achieve this in order to ensure that the innocent party is able to avoid the contract if it was obtained by the making of dishonest representations commonly referred to as misrepresentation as is illustrated by Figure 19.2 Misrepresentation.

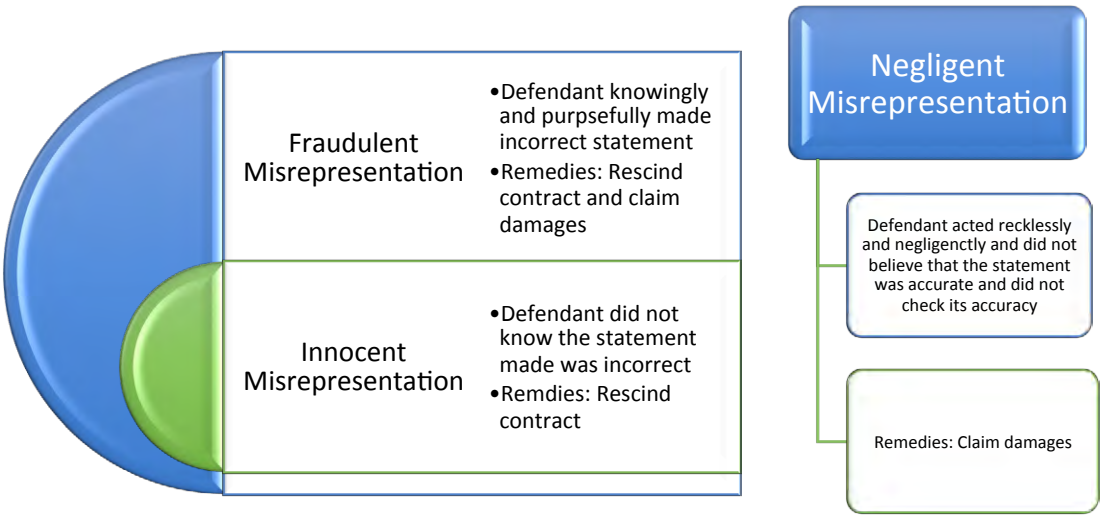


Figure 19.2 Misrepresentation

In this regard the common law misrepresentation overlaps with the Statutory misleading conduct provisions and in practice is only relevant where the consumer protection legislation do not apply; that is, in non-commercial contexts, as they only apply to commercial and business contracts, either face-to-face or e-commerce. For example the vitiating factor of misrepresentation, is only relevant where there is an actionable pre-contractual misrepresentation and where a party makes a 'false representation', either orally, in writing or expressed or by conduct, the representation is one of fact instead of a statement of opinion of law or a prediction about the future and it must be made to the other contracting party and it must induce the contract. Where the vitiating factor of misrepresentation is successfully proved and established the key remedy is the equitable remedy of rescission. Generally damages are not available unless the misrepresentation constitutes a tort, that is, it is also fraudulent or negligent, and in which case Tortious instead of contractual damages may be available. Even where misrepresentation is established there are some limits on rescission, especially and most significantly, if restitution or restoration for unjust enrichment is not possible the right to rescind will be lost. In some situations pre-contractual misrepresentations may provide contractual remedies at common law or under specific legislation.

19.6.1 Fraudulent Misrepresentation

Fraudulent misrepresentation differs from innocent misrepresentation because the actual intention to deceive is not present where there has been an innocent misrepresentation. Essentially, where there is an element of dishonesty in making the false statement then this situation gives rise to a fraudulent misrepresentation, one of the parties knowingly makes a false statement of fact, either recklessly, negligently or to mislead the other party with the clear intention of inducing the other person to enter into the contract, that causes the innocent party to suffer loss. There are a number of elements that must be established for fraudulent misrepresentation and include:

- false statement;
- of fact;
- lack of belief in its truth;
- inducing a party to contract.

At common law a contract that has been induced by fraudulent misrepresentation is voidable. This means that the innocent party may rescind the contract for fraud and also wile able to claim damages for any losses that were sustained and suffered as a direct consequence of the false misrepresentation. Alternatively, the innocent party may wish to continue with the contract regardless of the misrepresentation but will be entitled to claim only damages for any loss that may arise from the contract.

19.6.2 Innocent Misrepresentation

In situations where this is an innocent misrepresentation, the person making the innocent statement believes that it is true, and there is a lack of any dishonesty or intentional deceit by the person who made the statement. Essentially these types of statements are not actual terms of the contract and accordingly there are no remedies for breach under the common law unless there has been a total failure of consideration or the actual misrepresentation was in fact an essential and vital term of the contract. However, in some situations where the breach is serious, then common law will provide some remedy depending on whether the representation is deemed to be a condition or warranty. If the misrepresentation related to a condition being a vital term of the contract then the contract may be affirmed and the injured party can sue for damages; or secondly the contract can be treated as discharged and the innocent party can sue the other party for a total failure in non-performance of the contract. If however, the misrepresentation is merely a warranty being a term of lesser importance the only remedy available to the innocent party is to sue for damages. Accordingly, in situations where the misrepresentation is not a term in the contract, the injured party's only cause of action and remedy is under Equity.

19.6.3 Negligent Misrepresentation

In situations where there has been negligent misrepresentations the person makes an statement innocently, but recklessly and carelessly which in fact is false and upon which the innocent party relies on the negligent statement and suffers substantial loss. The main remedy under this type of misrepresentation lies in the tort of negligence for damages and the contract may be rescinded at the option of the injured party. This tort is based on and is established on their existing a 'special relationship' between the parties. In this regard, one party owed a duty of care in the giving of the information of which the matter was of a serious and/or business nature and that the person who provided the information must have known and realised that the party receiving the information intended to act upon it and relied on the other parties skill and expertise.

Key Points

The key points in this module are:

MO1: **Explaining the meaning of vitiating factors in contracts:** To 'vitiate' means to make faulty, injure, spoil or corrupt and in respect to contracts will render a contract legally ineffective or invalid, make void or voidable; to remove legal efficacy and binding force from a legal document and instrument such as a contract. For example duress or undue influence will render a contract invalid and void due to lack of genuine consent and in cases of unconscionability.

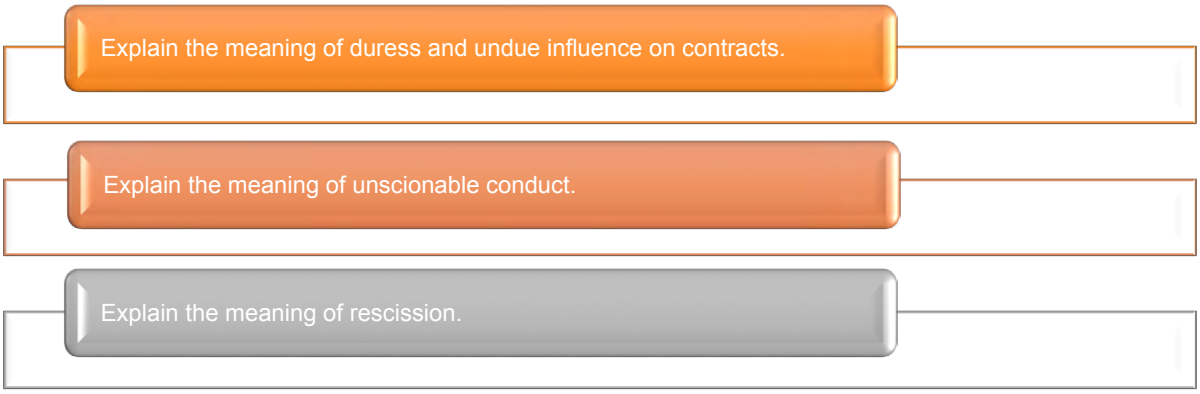
MO2: **Defining the different types of mistake, and its effect on contracts:** Contractual mistakes are errors made by one party or both of the parties to a contract while affects the validity of the contract at common law (vitiating factor). Mistake is classified as: common mistake where each party makes the same mistake and each is mistaken about the same fundamental fact; mutual mistake, where the parties are at cross-purposes and each meaning and referring to different things or subject matter and there is no 'consensus of the minds' – *consensus ad idem*; or unilateral mistake where only one party is mistaken as to the facts or subject matter of the contract and is rendered void or voidable.

MO3: **Distinguishing between innocent and fraudulent misrepresentation:** Innocent misrepresentation is when the maker of a statement of fact believes it to be true at the time of making the contract and there is a lack of intentional deceit for which there is no remedy in tort but a right in equity to rescind or resist an action for specific performance. On the other hand, fraudulent misrepresentation arises when a false statement of fact is made by the maker of the statement knowingly, or without the belief in its truth or recklessly, or carelessly as to whether it is true or false, with the intention to induce a person to enter into a contract, and which did induce the contract, causing the innocent party to suffer loss for which the remedy is in the tort of deceit for damages and the contract can be rescinded and or damages sued for at the option of the injured party in the contract.

Module 20 Application of Vitiating Factors

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this Module.

Duress: refers to threats of, or use of, force that deprives the innocent party of exercising their free will which lacks genuine consent in contracts.

Unconscionable conduct: refers to an unfair or unjust contract.

Undue Influence: refers to the use of influence or power by a stronger party over a weaker or vulnerable party.

Rescission: refers to an annulment of the contract making it *void ab initio* (void from the beginning).

Application of Vitiating Factors

In the introduction module to vitiating factors in contracts, a brief overview was provided in respect to the meaning and types of vitiating factors, that when applied under contract law, enable those questionable contracts to be avoided (or vitiate) that is to render those contracts defective, ineffective or void. In these circumstances the contract is rendered ineffective, such as for example, because the genuine consent of one of the parties to the contract was not give freely, that is there is no genuine consent and when there is evidence of fraud.

As was seen in the previous module, the remedy of Rescission is available in this instance and other remedies in the context of vitiating factors that are available to the innocent party were also discussed. The vitiating factors were identified and an explanation provided of each of the different types and their effect on the contract and remedies available to the innocent party.

In this module we still focus on these vitiating factors with a closer scrutiny of how they are applied in law and by the courts. A closer examination and discussion will be made of how the restrictions and technical difficulties of the vitiating factors mainly focusing on unconscionable conduct in equity, misrepresentation and rescission very often limit their effectiveness in assisting the innocent party thereby creating a need for statutory intervention in relation to and for the purposes of consumer protection.

20.1 Unconscionable Conduct in Equity

In respect to unconscionable conduct which deals with transactions between dominant and weaker parties the courts generally will set aside the contract as unconscionable if the plaintiff can prove the following:

- special disability or disadvantage at the time of the contract;
- defendant had knowledge of special disability or disadvantage; and
- defendant took unconscionable or unfair advantage or the disability.

Unconscionable or unfair conduct generally overlaps with duress and undue influence because of the unfairness of this type of conduct or behaviour it is prohibited under the common law, equity and under legislation, In situations where there is evidence of unconscionable conduct, equity will intervene in situations where one party has taken advantage of a 'special disability', such as age, illiteracy, lack of education or a combination of factors that are held by the other weaker and generally vulnerable party. As a result of this unconscionable conduct or behaviour the actual transaction is normally deemed to be harsh and oppressive to the weaker party.

In cases where unconscionable conduct or behaviour has been clearly established the weaker party may elect to avoid the transaction and not be bound by any obligations under it. It should be noted that the weaker party to rely on this vitiating factor to have the court set aside the contract must prove the above-mentioned three elements, that is, that he or she was under a 'special disability', knowledge of the other party of the special disability and taking unfair advantage of the special disability.

20.1.2 Special Disability or Disadvantage

In this instance the weaker party to the transaction must be under a special disability and this means that the person's ability to act in his or her own best interests is impaired and lacks of genuine consent. This position in law in respect to the application of unconscionability as a vitiating factor rendering a contract ineffective in adverse situations and which will apply to give rise to a special disability or disadvantage and such disability generally includes: poverty or need of any kind, sickness, age, sex, infirmity or body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary'.

20.1.3 Knowledge of Special Disability or Disadvantage

Thus the element of 'special disability or disadvantage' by one party due to the conduct of another, must also be proven for the successful application of this vitiating factor. In this instance it must be proven that the stronger party to the transaction must have known and have had actual knowledge or in fact ought to have known of the special disability or disadvantage of the other party.

20.1.4 Unconscionable Advantage of Disability

This element must also be proven for this vitiating factor to be applied to set a contract aside for unconscionable or unfair conduct. In this situation the stronger party must have taken unfair or unconscionable advantage of the special disability of the weaker party. Essentially, there must exist some abuse by one party of its superior bargaining position which often arises in contracts where one person is aware of the other party's disability and takes advantage of it.

20.2 Application of Misrepresentation

The law has for a very long time recognised the importance of proper and honest pre-contractual negotiations at the time of entering into agreement and contracts. The process of negotiation is an essential and vital part of commercial dealings and the Law at common law, equity and statute law strives to achieve this in order to ensure that the innocent party is able to avoid the contract if it was obtained by the making of dishonest representations.

It is very important that parties are given adequate scope in the negotiation and pre-contractual stage when providing each other with relevant information in respect to the subject matter of the contract being negotiated and what the best outcome and possible deal can be for each party from their personal points of view without the worry of attracting any legal liability at this initial negotiation phase. In this regard the common law misrepresentation as well as the statutory misleading conduct provisions of consumer law legislation and equivalents only apply to commercial transactions. In this regard an actionable pre-contractual misrepresentation occurs where a party makes a 'false representation', either orally, expressed in writing or by conduct. In this context the representation is one of fact, instead of a statement of opinion of law or a prediction about the future and it must have been made to the other contracting party and it was in the form of an inducement on the weaker party to enter into the contract.

In situations where the vitiating factor of misrepresentation is actually established the key remedy is rescission. Generally for misrepresentation damages are not available unless the misrepresentation actually constitutes a tort that is a civil wrong that is also fraudulent or negligent and- in which case Tortious instead of contractual damages may be available. Even where misrepresentation is established there are some limits on Rescission and most significantly, if restitution or restoration that is based on unjust enrichment where it is unfair if the defendant was allowed to keep the money or goods and services without payment and is a quasi-contract is not possible the right to rescind will be lost.

20.2.1 Principles of Misrepresentation

The vitiating factor of misrepresentation is simply a 'false statement of existing or past fact' that is made by one party to the other often weaker and disadvantaged party, during pre-contractual negotiations which is intended to and knowingly will have the effect of inducing the weaker party to enter the contract without true and genuine consent. In this instance the false representation is made orally or by implication or conduct but the fundamental basis and elements of the misrepresentation such as it being a false statement that is made by one party to the person seeking to rely on it before or at the time of the contract having regard to an existing fact or past event which is intended to induce the other party to enter into that particular contract.

Misrepresentation is very narrowly defined and it does not cover all types of statements or representations and excludes the following:

- statements of opinion provided that they are honest and not fraudulent;
- puffs or exaggerated sales talk;
- statements as to the future or predictions;
- silence, but there are some exceptions such as the nature of the contract such as insurance contracts or by conduct or prior dealings.

20.2.2 Remedies for Misrepresentation

If the vitiating factor of misrepresentation is established by the innocent party then there are a number of remedies that are available to render that defective or ineffective contract void or voidable. The contractual remedy for common law misrepresentation is rescission or the setting aside of the contract for this obvious defect. However, there are some limits or barriers to the remedy of rescission and sometimes if applicable and relevant will operate in order to prevent rescission from being available in some specific situations. Damages for misrepresentation are available only in tort. In practice and when the vitiating factor of misrepresentation is applied to a defective of ineffective contract damages in the form of monetary compensation may be available in the tort of deceit for fraudulent misrepresentation. In respect to the application of the vitiating factor of misrepresentation and if successfully applied and raised by the plaintiff, then damages may also be available in the tort of negligence for negligent misrepresentation. It should be noted however that even if this vitiating factor is applied, sometimes fraud and negligence are very difficult to establish and prove and that in this instance no damages will be available for innocent misrepresentation under the common law.

20.3 Vitiating Factors and Voidable Contracts

When a contract is made voidable due to the existence of a vitiating factor such as misrepresentation, mistake, undue influence, duress, unconscionable or unfair conduct the innocent or injured party has the right to repudiate that is reject the contract. A contract is said to be voidable when it has no legal effect and the injured or innocent party has the right to reject the contract and sometimes claim restitution and/or damages. When a contract is voidable essentially all of the legal obligations are effectively terminated as between the parties and they are back to the position before the contract was entered into.

This right or remedy arises in equity and is referred to as rescission which is often used to describe a termination of a contract. This equitable right arises when a contract is voidable because genuine consent is lacking and one party had induced another party to enter into the contract because of mistake, fraudulent misrepresentation, duress, undue influence or unconscionable conduct. In this instance the innocent party is able to continue with the contract ore rescind it, thus making the contract void and or voidable which means that it is treated as never having existed between the parties.

20.4 Remedy of Rescission

When the equitable remedy of rescission is applied it is distinguished from the usual remedies for breach of contract, namely damages (monetary compensation). Accordingly, the equitable remedy of rescission can be granted because of mistake, misrepresentation, undue influence, duress, unconscionability or under any consumer law legislation in respect to consumer protection. Generally, the consumer protection legislation provides that a consumer is entitled to rescind a contract for the supply of goods for breach of the implied conditions as to title, correspondence with description, merchantable quality, fitness for purpose and sale by sample corresponding to those that are implied in contracts of sale under sale of goods legislation. It should be noted that for rescission to be available to the injured party, substantial restoration or rectification must be possible.

20.4.1 Effect of Rescission

The requirement that parties must give true and genuine consent is a very important aspect of contract law. Accordingly the existence of a vitiating factor, such as misrepresentation, mistake, undue influence, duress, unconscionable or unfair conduct, renders the contractual consent given at the time of the negotiation without genuine and voluntary consent invalid and hence the contract will be void or voidable. In this sense, the contract is, either of no legal effect, that is void, or at the option of the innocent party, may be rescinded or avoided (voidable). The main aim of rescission is to essentially return the parties to their original and pre-contractual positions, which means that that the parties are returned or substantially returned to the position in which they would have been if no contract had taken place in the first instance. In this regard the equitable remedy of rescission is essentially backward looking, and it seeks to restore the parties as far as is possible to the positions that they had occupied before the contract was made.

20.4.2 Principles of Rescission

Rescission has its origins in common law, but the equitable rules actually govern it today in order to provide more flexibility as this remedy needs accurate and precise restitution or restoration when applied to business and commerce. If this were not the case, then the vitiating factors would continue unchecked and without any redress or remedy to the injured or innocent party. Equity therefore allows substantial instead of exact restitution to be made when there is clear evidence of vitiating factors that render contracts of no legal effect and void or voidable by the making of proper, accurate and genuine financial payments and compensation as between the parties. In respect to the application of the equitable remedy of rescission a contract is actually rendered void for operative mistake, which simply means that there was never a valid contract. In all other cases that involve a vitiating factor apart from mistake, the party that is affected has the right either rescind the contract or to go ahead with the contract as it is voidable at the option of the injured or innocent party.

In the application of this remedy where vitiating factors have been evident, if the innocent or injured party decides not to rescind, or if the right to rescind has been lost, due to the limits or barriers of rescission, then the contract is valid. Two examples of a limit to rescission is where restitution or substantial restitution is not possible as where goods have been consumed or perished or have been substantially altered or where a business has closed down as well as where there has been a lapse of time, as there must not be any undue delays in seeking the remedy of rescission when claiming and applying the occurrence of a vitiating factor on the basis that the contract lacks true and genuine consent.

Key Points

The key points in this module are:

MO1: Explaining the meaning of 'Duress' and 'Undue Influence': Duress is the use of violence or illegal threats against a person, their goods or their economic interests in order to force them to enter a contract against their will (lacking genuine consent) and there is a lack of a voluntary and willing agreement and the effect on the contract is that it will render it voidable. Undue influence involves the improper use of a position of power or influence possessed by one person over another in order to induce them to act for the former's benefit and as a result there is a lack of genuine consent to the agreement and like duress, undue influence looks to the quality of the consent or assent of the weaker party. Such remedial action is based on equity and the usual remedy is rescission if the innocent party elect to have the contract set aside on the grounds of undue influence.

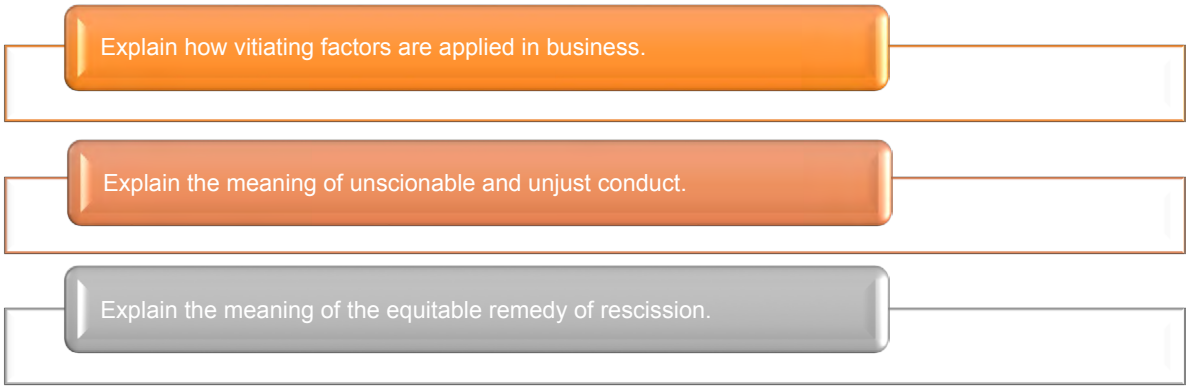
MO2: **Explaining the meaning of unconscionable conduct:** Unconscionable conduct is a contract that is unfair, harsh or unjust and there has been an abuse by the defendant of their superior bargaining power. Any unconscionable conduct that leads to an unconscionable contract involves questions of fact and degree of the unconscionability, and each case is determined on its fact. If the facts show that the conduct of the defendant was such that in its factual setting fairness and good faith should have been exercised and were not, then the conduct of the defendant is deemed to be unconscionable.

MO3: **Explaining the meaning of Rescission:** Rescission is both a common law and equitable remedy that enables the deceived party upon discovery of the misrepresentation under the contract to either affirm or rescind (annul) the contract and renders the contract *void ab initio* (from the beginning).

Module 21 Vitiating Factors in Business

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Unconscionable conduct: refers to an unfair or unjust contract.

Undue Influence: refers to the use of influence or power by a stronger party over a weaker or vulnerable party.

Vitiating Factors in Business

This Module will focus on the general intervention of Statute law in relation to these various vitiating factors, such as all types of misrepresentation, mistake, duress, undue influence, unconscionable or unjust conduct for the purposes of consumer protection. As was mentioned earlier, vitiating factors operate to render a contract void or invalid for lack of true, real or genuine consent. It was also highlighted that the vitiating factors of undue influence and mistake are not as important in Australia as the doctrine of unconscionability which has nowadays taken over most of the area of the law that was occupied by undue influence. This module therefore will focus on general legislation and its direct link with common law vitiating factors which have now been codified for the purposes of consumer protection when doing business especially when entering into contracts for sale of goods and other commercial contracts and their application to business and commerce. In general, the trade practices legislation of jurisdictions applies to all transactions for the supply of goods and/or services provided that the transaction involves a 'corporation' or certain individuals and non-corporate bodies that regulated by the consumer laws of that jurisdiction for the purposes of consumer protection.

21.1 Statutory Unconscionability

The equitable doctrine of unconscionable conduct as laid down and highlighted by court decision in various jurisdictions was that the plaintiff is required to prove among other things, a special disability or special disadvantage. This requirement in practice often places a huge restriction on the effective operation of the equitable doctrine and in general business and commercial practice this was not a regular occurrence or in the nature of the specific 'special disability' as stated in the legislation.

The positive outcome of increased consumer protection awareness at all levels in the market place at local, national and international levels of trade and business was that there were a number of statutory interventions and new provisions introduced for the purpose of increasing consumer protection beyond the limited scope of the equitable doctrine of unconscionability. Some of these provisions included the following:

- to give protection from unconscionable conduct to consumers;
- to give legislative expression to the equitable doctrines of unconscionable conduct and what it means by, having a 'special disability' and to provide the innocent party with certain procedural and remedial advantages;
- to protect small business from unconscionable conduct when dealing with larger corporations in business or commercial transactions.

In respect to statutory unconscionability there are three main statutory provisions that prohibit unconscionable conduct in certain commercial and business circumstances. When applying these principles to business and commerce it is essential that the differences between them are clearly understood as they give rise to different outcomes in the application of the different provisions various legislation within jurisdictions. These three important consumer protection statutory provisions include:

- unconscionable conduct in consumer transactions;
- unconscionable conduct in business transactions; and
- unconscionable conduct within the meaning of the unwritten law of the States and Territories.

21.1 Unconscionability and Consumer Protection

In general the legislation of jurisdiction to promote and enhance consumer protection operate concurrently with other local domestic consumer laws which operate to ensure that any person or corporation shall not, whether in trade or commerce in connection with the supply or possible supply of goods or services to a person being the consumer, engage in any activity or conduct that is harsh, unjust, misleading and unconscionable pursuant various consumer protection legislation of that particular jurisdiction.

In essence, consumer law legislation refers to conduct that is unconscionable within the meaning of the 'unwritten law', that is, conduct that is essentially regarded as unconscionable by the Courts in accordance with the common law or equitable principles that are often derived from various case decisions involving consumer law issues such as unjust, harsh, misleading and unconscionable conduct against a 'consumer' by a corporation or other person for 'personal, domestic or household use or consumption'.

21.1.1 Ascertaining Unconscionable Conduct

In attempting to ascertain whether there has been unconscionable conduct, a number of guidelines have been used by the courts and include:

- relative bargaining power of the company and the consumer;
- whether the conditions in the contract went further than was reasonably necessary to protect the company;
- whether undue influence, pressure or unfair tactics were used by the company or its agent during the negotiations;
- whether the consumer understood the documents; and
- whether the price and availability of the goods were more onerous than what could have been obtained somewhere else.

It should be noted that there is generally no statutory definition of unconscionable conduct for the purposes of consumer law legislation as to do so would be inflexible in the application of consumer laws. However, there are a number of factors that the courts may take into consideration when determining whether the vitiating factor of unconscionable conduct has taken place during the negotiation of the contract between the parties.

Essentially these factors consist of procedural and substantive factors in ascertaining the extent and scope of the unconscionable conduct such as whether there was any 'special disability' on the part of one party and whether there were any harsh, unfair or onerous terms in the contract.

Accordingly, when the vitiating factor of unconscionable conduct is proven in business or commerce by an innocent party, before it is able to operate effectively and provide some redress and remedy to the innocent party, the following elements must be established, namely:

- a corporation;
- in trade or commerce;
- in connection with the supply or possible supply of goods or services;
- to a consumer;
- shall not engage in conduct that is, in all the circumstances, unconscionable.

Where there has been a contravention of this statutory provision relating to unconscionability then the consumer laws would provide the innocent party with a broad range of remedies relating to unconscionability, including in equity an injunction, common law damages, or orders to either rescind or vary the contract to make it more fairer and just.

21.1.2 Unconscionable Conduct in Business Transactions

The consumer protection legislation of jurisdictions also deal with unconscionable conduct in business transactions and is identical to the common law duty of care not to mislead or deceive parties in business transactions. This is generally provided for by ensuring thorough legislation that corporations must not engage in conduct that is unconscionable to a 'business consumer'. The main objective of consumer protection legislation is to protect small businesses that enter into commercial agreements and contracts with lager businesses and corporations. Thus, in accordance with these various consumer law legislation, a corporation must not, in trade or commerce in connection with the supply or acquisition or possible supply or acquisition of goods or services to or form a person or a corporation, other than a listed public company, that is, a business consumer engage in conduct that is, in all the circumstances, unconscionable.

In order to this provision to effectively operate and be applied where the vitiating factor of unconscionable conduct is present, the requirements or elements of this section that need to be proved by the innocent or injured party are:

- a corporation ("the supplier")
- in trade or commerce
- in connection with the supply or acquisition, or possible supply or acquisition of goods or services
- to or form a person or a corporation (excluding a listed public company) – the business consumer
- must not engage in conduct that is, in all the circumstances, unconscionable.

There is generally an inbuilt mechanism and checklist in the various legislation that supplements the general law and operates to assist the court in ascertaining if conduct is unconscionable including:

- the consistency of the supplier's conduct towards similar business consumers in similar situations;
- any requirements of established industry codes or conduct and practice;
- non-disclosure by the supplier of any conduct that might affect the interests of the business consumer or any risks that may arise to the business consumer from the suppliers intended conduct;
- the extent to which the supplier was willing to negotiate the terms and conditions of any business contract for the supply of goods and services with the business consumer; and
- the extent to which the supplier and the business consumer acted in good faith.

It should be noted that there is no general statutory definition of unconscionable conduct for the purposes of consumer legislation. However, the courts often take into account the nature of the alleged 'unconscionable conduct' when determining whether the vitiating factor of unconscionable conduct has taken place during the negotiation of the contract between the parties. Essentially apart from this factor, other factors that the courts take into account include procedural and substantive factors in ascertaining the extent and scope of the unconscionable conduct such as whether there was any 'special disability' on the part of one party and whether there were any harsh, unfair or onerous terms in the contract.

Accordingly, when all of these elements are proven by the innocent party to an unconscionable contract, the corporation is in contravention of the consumer protection laws or the trade and commercial practices legislation of that jurisdiction and then the innocent party will be entitled to a remedy relating to unconscionably, such as under equity an injunction, common law damages or court orders to either rescind or vary the contract as deemed necessary under the particular circumstances.

21.2 Meaning of Unconscionable Conduct

The term unconscionable conduct refers to conduct that is unconscionable within the meaning of the 'unwritten law', that is conduct that is regarded as unconscionable by the courts in accordance with the common law or equitable principles. In respect to the vitiating factor of unconscionable conduct it does not create or provide any new legal rights to the innocent or injured party who has some special disability of which the stronger party was or ought to have been aware at the time that the contract was entered into. This essentially means that, a corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the consumer legislation or any of the fair trading or consumer law provisions which operates to prohibit 'persons' or 'suppliers' from engaging in unconscionable conduct or trade which is a vitiating factor rendering the contract void or voidable. States have similar provisions which empower the court to grant relief in respect to 'harsh, oppressive, unconscionable or unjust contracts' by refusing to enforce the contract or declaring the contract void or varying the terms contained in it partially or wholly. Regardless of which approach is taken by the Courts, its takes into account a number of important matters such as bargaining inequality and the use of unfair tactics by the stronger party against the weaker party, as well as the potential impact of the circumstances of the case involving this vitiating factor on the wider community. Accordingly, the requirements or elements any consumer law provision in legislation to ensue protection of consumer in consumer contracts and transactions are and include:

- a corporation;
- in trade or commerce;
- must not engage in conduct that is unconscionable;
- within the meaning of the unwritten law of the states and territories.

21.2.1 Unequal Bargaining Power

When all of these elements are proven by the innocent party to an unconscionable contract, the corporation is in contravention of these provisions and the innocent party will be entitled to a remedy relating to unconscionability, including the equitable remedy of injunction, common law damages or orders to either rescind or vary the contract as deemed necessary. Some particular circumstances of cases involving vitiating circumstances such as unconscionable conduct that would be taken into account by the courts include:

- the relative bargaining strengths of the parties;
- whether the disgruntled party could negotiate changes;
- whether independent legal advice was sought or could be sought;
- what normal commercial practice was;
- the complexity of the language used;
- the age, health and mental capacity of the parties; and
- the education, literacy and economic circumstances of the parties.

21.2.2 Remedies

In situations where the plaintiff was in a position to fully understand exactly what they were doing, such as for example where independent expert advice was obtained, then any relief under statute would probably not be available because of the inherent difficulty in actually establishing that it was 'unjust' within the meaning of any consumer legislation or trade practices act within that jurisdiction. The main purpose of statutory unconscionability is that it provides the innocent party better access to and more flexible remedies under the consumer protection laws as opposed to under the common law and equity which in some instances may have certain limitations such as in the equitable remedy of rescission.

21.3 Misleading (Deceptive) Conduct

In this regard to the various consumer laws including the fair trading and trade practices act of the various jurisdictions, are very important in that in a many situations they have enhanced and strengthened the remedies that are available for misrepresentation under the common law on business contracts and transactions. Essentially these different types of consumer legislation and fair trading acts are directly concerned with a number of different unfair conduct or behaviour that takes place in commerce or business in various transactions and contracts for the supply of goods and services, such as false, deceptive and misleading statements. Thus, the consumer protection and fair trading legislation when applied to business attempts to protect consumers and it operates to prohibit a corporation that is in trade or commerce from engaging in conduct that is misleading and deceptive or can mislead or deceive when negotiating a contract or other business or commercial transactions. This type of conduct that is complained of and gives rise to an actual breach must arise in trade or commerce by a corporation or other business entity, that is, the conduct must have some trading or commercial character to it in order for the provision to apply.

Under the provisions for misleading conduct, generally it is not essential to prove that that misleading conduct was actually deliberate, and accordingly there are no criminal penalties attached to such provision for a breach. However the remedies that are available when there is a direct breach of any misleading or deceptive conduct, and when it arises in business are damages, injunctions or orders to correct the advertisement by the corporation or business which is misleading and deceptive to consumers and the wider community. In respect to what constitutes 'conduct', generally under trade practices acts, it is defined as "doing or refusing to do any act' and it has a very wide meaning. This general definition of conduct is effectively much wider that the concept of 'misrepresentation' as understood under the common law even though in most situations, the conduct itself does in fact amount to a misrepresentation. The 'misleading act' clearly defines though broadly conduct that is captured by any consumer provision prohibiting such acts or conduct. These acts or conduct generally includes statements that have been made whether expressly, orally or visual such as advertisements. However apart from this conduct which are prohibited conduct under general consumer law provisions, can in some situations depending on the gravity or serious of the breach and loss by the innocent party include the following:

- statements are literally true;
- promises;
- statements of opinion;
- deliberate inaction;
- salesman's puff, puffs or puffery;
- professional advice.

There are also a number of provisions regarding representations that relate to business in the provisions of goods and services, false or misleading representations; false representations and other misleading or offensive conduct in relation to land; offering gifts and prizes; certain misleading conduct in relation to services; bait advertising and misleading representations about certain business activities. A full discussion is beyond the scope of this module but have been mentioned here to reinforce the importance of consumer protection in this area.

21.4 Commercial Character of Conduct

In various situations where the misleading conduct has taken place in trade or commerce. Consequently, the consumer protection legislation of jurisdiction has been used extensively by consumers taking action against seller and suppliers of goods as well as services, but also in action being taken by competitors in the marketplace where trade and commerce operates and is conducted on a daily basis. In this sense, consumer law protection legislation and the manner in which it has been applied in recent times as evidenced by court decisions has effectively been used as an alternative action for redress and compensation in the tort of passing-off for:

- misleading or disparaging representations that were made in the advertisement;
- the publishing of tests and surveys, which may not have been out carried out or only partially carried out;
- claims in relation to the country of origin of the goods complained of; and
- the use of similar names which confuses the public.

Essentially, the fundamental basis of the meaning, objective and application of any misleading and deceptive conduct provisions is to protect consumers and the public in general from such unfair and unjust conduct. Accordingly, as a consequence of the wide meaning, interpretation and application of any consumer law provisions of in respect to misleading and deceptive conduct, such as when statements are published and made in the ordinary course of business such as through the medium of the media whether in newspapers, radio, television or the internet, then it may be possible that the conduct in some situations could amount to misleading or deceptive conduct. In situations where there has been conduct that is misleading or deceptive it is generally up to the courts to determine by applying an objective test if the conduct is misleading or deceptive.

21.5 Causation

To establish a successful misleading and deceptive claim, it is necessary to show that the misleading conduct actually caused the loss and the establish 'causation':

- it is necessary to show that the conduct was actually misleading. This means that something was said which was incorrect and that this led the other party into making a mistake. The wrong information must have been relied on by the innocent party and there must be a causal connection between the wrong information and the innocent party's mistaken belief in its truth which was misrepresented.
- the misrepresentation must be causative of loss and generally the consumer law in this regard states that it provides "…a party to the proceedings has suffered, or is likely to suffer, loss or damage…" So, even if the misled party is seeking an order for rescission, the innocent party must be able to show that actual loss was suffered, has been suffered, or is likely to be suffered and actual loss or damage has had occurred are a result of the misrepresentation.

21.6 Remedies for Contravention

In respect to a contravention of the prohibition against misleading or deceptive conduct under the consumer protection and trade practices acts of jurisdictions thee following remedies are available:

- Injunctions;
- Damages; and
- Ancillary orders for, among other things, rescission or variation of the contract.

In should be noted that generally the statutory remedies are better than the remedies that are available under the common law in respect to misrepresentation, misleading or deceptive conduct or statements. Under statute law the damages that are available as a consequence of any loss suffered 'by conduct' can be recovered from any person that is actually 'involved' in the contravention and not just the business organisation or company that is responsible for such consumer law breach. Also, in respect to any statutory damages for misleading or deceptive conduct or behaviour, the courts generally have powers to make other common law compensatory orders under the law, including the power to rescind contracts, which is are much more flexible than the common law remedies and are much wider in their application.

In respect to the quantum of damages to be awarded for any such breach involving misleading and deceptive acts and conduct, it is usually assessed by determining how much worse off the plaintiff is as a result of misleading or deceptive conduct. Under laws in respect to misleading or deceptive conduct, those buyers who rely on the sellers misrepresentations without taking due care themselves are said to contribute to their loss and accordingly buyers must always fully inform themselves and make necessary and relevant enquiries before entering into a business or commercial transactions or contract.

The legislation in this regard, provides a variety of remedies for such breach of any misleading and deceptive conduct provisions, including the injunction remedy which is appropriate for advertising cases but not for pre-contract negotiations. However the other remedy provisions also apply in some situations but it is necessary to establish a 'causal link' or 'causation' between the misrepresentation and the harm or loss sustained as a result of the misrepresentation.

26.1 Injunction

The equitable remedy of Injunction (to stop)remedy is the usual form of remedy in respect to contract negotiation situations but it is also a beneficial remedy in respect to misleading advertising as it is possible to stop the publication of the misleading advertisements. Thus if the law deems that the words "*or is likely to mislead or deceive*" are aimed at advertising situations than those publications and advertisements can be stopped from being published or placed in the public domain by advertisements. In contract negotiations it is pointless in complaining that a statement is likely to mislead or deceive and it must do so in order for this consumer law to operate and apply to compensate an injured party who was misled or deceived. However, in advertising situations it is of some importance to be able to stop an advertisement before it does any harm, that is, it can be shown that it is likely to mislead consumers of the one of the parties to the negotiation.

26.2 Damages

The damages section of any consumer and trade practices legislation of jurisdiction usually uses the word "by" to make the link between the relevant conduct and the loss arising from the conduct. The use of the word "by" in this context has been used by the courts when considering situations where it is advisable to reduce damages because of the negligence of the plaintiff in not minimising the harm or loss.

Essentially, in some instances and in the calculation of damages, the consumer law provisions often imposes absolute responsibility on people who make statements, provide information to ensure that is it not misleading or deceptive but does not place any responsibility on those persons receiving the information to check its accuracy. In this regard. the type of damages that a court can award are generally referred to as reliance damage instead of expectation damages which are only awarded in contract actions situations for breach of contract.

26.3 Ancillary Orders

The court with the ability to make very flexible orders if a breach of any provisions relating to misleading and deceptive acts and conduct have taken place which differs to traditional contract remedies in the flexibility offered by the section. To obtain such ancillary orders the plaintiff, must show that loss has been suffered or is likely to be suffered by reason of the conduct constituting the misleading and deceptive conduct. In such situations, the court is then empowered to make "such order or orders as it [the court] thinks appropriate…" and the court may order compensation, may make an order to prevent or alleviate future loss, may declare a contract to be void in whole or in part, from the beginning or from a particular point of time onwards, may make an order varying a contract, prospectively or retrospectively, may make an order that a certain term or terms will not be enforced, may make an order refunding money or returning property, may make an order for repair or to supply spare parts, may make an order to supply specified services, or make an order that a party execute an instrument, such as a contract.

26.4 Misrepresentation and Statute Law

During the course of negotiations there may be misrepresentation by one of the parties who may have said something which influenced and/or induced the other party to enter the contract which was wrong as the facts were misrepresented or made false. Also during the course of the negotiations one of the parties may have improperly exerted pressure on the other party by way of duress or undue influence over the other party, or acting in a manner that is unconscionable, or using unfair pressure in order to get the other party to agree.

These types of conduct or tactics under the general law may allow the innocent party rescind the contract (remedy of rescission), that is, be rid of the contract as if it had never been entered into with the other party. Under the general law this is the basic remedy for this kind of conduct and in this instance the contract may be terminated (discharged) and the parties will be restored to the status quo prior to the contract. In respect to misrepresentation when negotiating a contract, if a contract is one which may be rescinded, then it is said to be voidable, which means that the contract is still valid until it is avoided or rescinded by the innocent party. Consequently as a result of this defect arising as a result of the vitiating factors of duress, undue influence or misrepresentation a negotiated contract may be:

- void , for uncertainty;
- unenforceable, such as non-compliance with the statute of frauds or because a limitation period has expired; or
- voidable, such as for misrepresentation, mistake, undue influence, duress, unconscionability in bargaining power between the parties.

The common law has not always provided the plaintiff with legal remedies in the case of innocent misrepresentations, and enacted statutes have been mainly concerned with providing remedies in such instances. Accordingly, there are a number of statutes that impose new and serious liabilities on those persons who make misrepresentations which cause severe financial loss to the innocent party who relied on that misrepresentation.

These consumer protection and fair trading Acts effectively provide remedies to the innocent party in the form of damages and also allows for the equitable remedy of rescission in some situations, such as were the contract had been induced by misrepresentation either fraudulent or innocent if the harm or loss was severe on the party who had relied and acted on the representation. Statute laws effectively operate in business and commerce where there the vitiating factor was of a serious nature and consequences and operate by the imposition of liability on anyone who makes a misrepresentation whether made fraudulently or innocently.

Essentially a voidable title arises under a sale of goods contract which is a voidable contract, where there is a unilateral mistake in respect to identify, misrepresentation, duress, undue influence and unconscionable conduct. The focus here will only be made on the vitiating factor of misrepresentation. Misrepresentation is a false statement that is made during the course negotiations which induced the other party to enter into the contract. As a direct consequence of the misrepresentation the innocent party who has been misled is able to rescind the contract and or sue for damages. The law of misrepresentation is generally complex because of the application of two sources of law:

- Common Law – the general law which is a combination of the general common law and equity law; and;
- Statute Law in relation to consumer protection, trade and fair treading provisions of the jurisdiction.

In most jurisdictions, the general common law in respect to consumer protection has been replaced by statute law in respect to misrepresentation but still draws on the common law and equity law in some situations in order to rectify the defect in the negotiations between the parties and to provide some remedy to the innocent party.

26.4.1 Sellers Exclusion Clauses

Even though under some common law situations in respect to issues pertaining to breaches of consumer law, such as attempts by parties to a negotiation or sellers to exclude liability has been unsuccessful. However, some judgments have made it clear that an exclusion clause, in specific situations, can be effective to protect the person relying on it from liability in respect of what would seem to be a very serious breach of contract. Also, it some situations it is also possible to exclude liability for negligence, provided the clause is appropriately drafted and all parties are aware of the exclusion clause and constructive notice has been brought to their attention. However, despite the exceptions as stated above, generally it is not possible in commerce or business to exclude liability for misleading and deceptive acts, statements or conduct.

This is because under statute law any form of misrepresentation where one person misleads another person in business whether in pre-contractual negotiations or under sale of goods is deemed to constitute a misrepresentation and the main question that had to be established is whether there has been misleading conduct. In respect to the operation of any provisions and its link with misrepresentation, there are a number of very important aspects derived from case law in relation to misrepresentation, namely that:

- silence can be misleading conduct, that is, in a particular context a failure to speak or explain will be misleading;
- exclusion clauses do not work;
- there is no concept of contributory fault in such cases and the person who engages in misleading conduct takes entire responsibility for any harm caused by that conduct, however stupid or negligent the other person has been; and
- the remedy of rescission is discretionary.

Key Points

The key points in this module are:

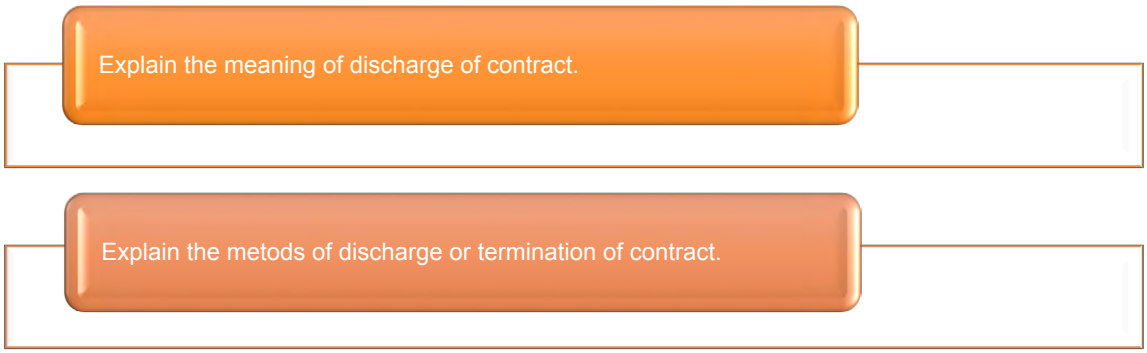
MO1: Explaining how vitiating factors are applied in business: In contract law and equity vitiating factors are circumstances that vitiate or tend to vitiate (make faulty and or defective) the effect of an instrument or transaction and are factors that render the contract invalid and subject to being declared void for unconscionability and include fraud, mistake, misrepresentation, duress, undue influence, and unconscionable conduct and contracts.

MO2: Explaining the meaning of unconscionable and unjust conduct: In contract law unconscionable conduct is where one party asserts a unilateral mistake or undue influence exploiting the vulnerability of the other party due to some disadvantage. Whereas unjust or unfair conduct is one where it is inequitable to respect compliance as it would cause severe personal and economic detriment.

Module 22 Discharge of Contract

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Actual Breach: is the breach of contract due to a failure to comply with a fundamental term of the contract.

Anticipatory Breach: refers to threatened failure by one party to the contract to perform their contractual obligations at a time that was required by the contract and as agreed.

Assignment: refers to a transfer of rights under a contract by a deed of novation (new deed/transfer)

Divisible Contract: refers to a contract that ca be divided up into separate parts and arises in situations of partial performance of a contract.

Frustration: refers to the discharge of a contract that is rendered impossible of performance to due to unforeseen external factors.

Privity of Contract: is the rule that only parties to the contract are directly affected by it.

***Quantum meriut*:** arises in cases of partial performance and means as much as a person has earned or as much as that person deserves.

Discharge of Contract

In this Module the discharge or termination of a contract, that is, how a contract is brought to an end will be discussed. A contract comes to an end in a number of various ways depending on how the contract was initially performed and formed. Most contracts come to a natural end as a result of the parties performing their respective obligations as agreed to during the negotiations which led to the formation of the contract. Essentially, the requirements for 'performance' to discharge contractual obligations will be discussed in this module. A contract may also come to an end by the actual agreement between the parties or as a result of the breach of contract by one of the parties. Finally, a frustrating, such as where the contract is frustrated where the subject matter of the contract is destroyed or substantially altered or any other unforeseen event might prevent parties from performing as planned and this may have the effect of terminating a contract.

A contract may be discharged in a number of ways; most commonly through performance, by the parties, of their contractual obligations. As a general rule, for a contract to be discharged by performance the contractual obligations must be performed completely and exactly; it is not sufficient to 'substantially' perform a contract. There are, however, some exceptions to the rule that exact performance is required and in some instances the parties may also modify this requirement either expressly or impliedly by providing that exact performance is not required. Determining the relevant level of performance will, therefore, depend on proper construction of the contract involved.

22.1 Release of Obligations by Discharge

A party's duty under a contract is to discharge their obligations under it by performing it as agreed or as closely as possible without any breaches. One a party has discharged their obligations either by full performance or partial performance (if accepted by the other party) they are then excused from any further performance under the contract. The *Oxford Dictionary* states among other things that the word 'discharge' means to unload, rid of, relieve of, or release from obligations. In the context of business law, the word 'discharge' refers to the 'extinguishment or release of obligations under a contract'. Therefore the word 'discharge' in respect to contract law, when a contract is described as being discharged, refers to the fact that the parties to the contract are 'excused' from further performance of their obligations under the contract.

As a direct consequence of the discharge there is nothing left for the parties at law to do under the contract. A party may be discharged from their duty and obligations under the contract because they have performed their obligations, or promises in full. If they have done this, then the contact is deemed to have been fully executed. However a discharge of contract does not merely arise where the contract has been totally or fully performed and there are a number of other ways or methods of discharge or termination by which a party, or even both parties, may be discharged (excused) from their obligations.

22.2 Methods of Discharge of Contract

A contract is discharged when the parties are no longer bound by it, either because the contract has been successfully completed or completion of the contract is no longer possible. A contract therefore, may be discharged in a number of ways, in which a party or both parties may be discharged from further performance. A contract may be discharged or terminated bringing the contract to an end in the following ways and as illustrated by Table 22.1 Methods of Discharge of Contract.

The actual discharge or termination of the contract will depend on the nature of the contract and the manner in which it was actually constructed and agreed to between the parties as what will constitute and/or give rise to its termination. Accordingly, a contract may be terminated in the following ways termination by:

- performance of the contract, wherein the obligations of both parties are performed;
- agreement between the parties, wherein the parties agree to end the agreement or substitute a new agreement;
- frustration, wherein a supervening and unforeseen event makes performance of the contract impossible or makes the contract fundamentally different;
- actual or anticipatory breach, wherein one of the parties breaches a condition of the contract and the innocent party chooses to end the contract;
- operation of law, wherein the law deems the contract as coming to an end by the operation of certain legal rules, such as bankruptcy;
- by subsequent agreement, wherein the parties may make a further and later agreement that varies or totally discharges the original contract by a deed of novation; and
- by election after breach, wherein the innocent party may be able to treat the contract as discharged because of that breach which may be actual breach or anticipatory breach.

Method	Description
Performance	The parties to the contract carry out exactly the terms (the promises) of the contract. In limited cases substantial performance, acceptance of part performance and obstruction by the other party may discharge the contract
Agreement	As the contract was created by agreement, so it can also be changed by agreement. This can be by way of mutual discharge, a release or waiver by one of the parties, a substituted agreement or accord or satisfaction.
Frustration	Contract discharged as a result of impossibility of performance due to unforeseen events by either party, such as destruction of the subject matter, change in the law, physical impossibility under a contract of personal service or a radical change in a state of affairs.
Operation of Law	The contract may be discharged independently of the wishes of the parties by operation of law, such as by bankruptcy, material alternation, merger, death of either party or expiry of time.
Lapse of Time	Where no time has specified, a reasonable time has elapsed.
By Virtue of a Term	A term incorporated into the contract bringing it to an end, that is, as condition subsequent, or term preventing an agreement becoming a contract, that is, a condition subsequent.
Breach	By one of the party failing to perform their obligations as promised and agreed.

Table 22.1 Methods of Discharge of Contract

Key Points

The key points in this module are:

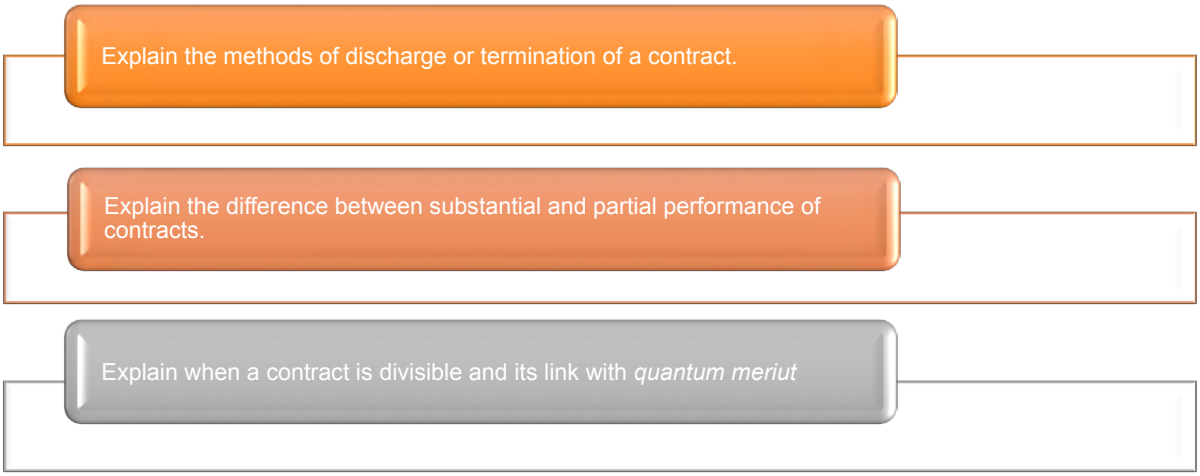
MO1: **Explaining the meaning of discharge of contract:** In contract law release from a contractual obligation such as a repayment of debt either through performance.

MO2: **Explaining the methods of discharge or termination of contract:** There are a number of methods of discharge or termination of a contract and they includes full performance, mutual agreement, expressed release or waiver, accord and satisfaction or by operation of law which makes the contract fully discharged.

Module 23 Effect of Discharge of Contract

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Actual Breach: is the breach of contract due to a failure to comply with a fundamental term of the contract.

Assignment: refers to a transfer of rights under a contract by a deed of novation (new deed/transfer).

Anticipatory Breach: refers to threatened failure by one party to the contract to perform their contractual obligations at a time that was required by the contract and as agreed.

Divisible Contract: refers to a contract that ca be divided up into separate parts and arises in situations of partial performance of a contract.

Frustration: refers to the discharge of a contract that is rendered impossible of performance to due to unforseen external factors.

Privity of Contract: is the rule that only parties to the contract are directly affected by it.

***Quantum meriut*:** arises in cases of partial performance and means as much as a person has earned or as much as that person deserves.

Effect of Discharge of Contract

A valid contract is effectively discharged when the parties are no longer bound by it, either because the contract has been successfully completed or completion is no longer possible. It was mentioned that a contract therefore can be discharged or terminated by either actual or attempted performance; by agreement between the contracting parties; by frustration; by operation of law; by an actual or anticipated breach and by any specific term that is contained in the contract.

The word 'discharge' means to unload, rid of, relieve or release from obligation. In law a contract is said to be discharged when the parties are effectively 'excused' from further performance of their obligations under the contract. When the discharge has effectively taken place, there is nothing further that the law requires both parties to perform under the contract. There are various ways in which a party or both parties may be discharged from further performance and includes performance; agreement; subsequent agreement; operation of law; election after breach and frustration.

23.1 Discharge (Termination) by Performance

A contract is generally discharged when both parties to the contract actually perform their promises and obligations as promised. Where the parties totally and actually perform their promises then the contract is discharged by way of performance and there is nothing further for the parties to do under it as the respective obligations have been discharged and as a result the contract is at an end. Accordingly, a contract is discharged when all the obligations under the contract have been performed. For the contract to be discharged it must be usually carried out within the specified time frame, or within a reasonable time if no actual time has been specified. Also, before the contract is discharged if the actual promised act requires some special skill, then the promisor must do it personally in order for the contract to be discharged or terminated. Also in order for the obligations to be satisfied under the contract, performance must be exactly what was specifically required under the contract. This means that the performance must be exactly what was required and unless all the work has been completed, the party will be treated as if they have done no work at all.

This situation often leads to unfair and inequitable results where a party is unable to claim payment for work that was completed unless 'all the work has actually been completed' which the court has held that the plaintiff is not entitled to any payment until all the work was completed exactly as agreed to under the contract. As a result of these unfair decisions, the common law has allowed some exceptions to the general rule that performance of a contract must be complete and exact and include:

- substantial performance;
- acceptance of partial performance;
- divisible contracts.

In respect to discharge or termination by substantial performance or partial performance, performance of the contract must strictly conform with the promises that were made between the parties during the negotiation of the agreement which led to the formation of the actual contract. In some situations the courts will allow the contract to be discharged or terminated through reduced performance or in situation of divisible contracts.

23.2 Substantial Performance

If the breach is minor and one party has substantially completed a contract, the courts have developed the doctrine of substantial performance. This doctrine of substantial performance acknowledges the fact that in some situations a party who has substantially completed a contract will be entitled to seek performance from the other party. In this regard, the court takes into consideration that although full performance has not actually occurred, there is sufficient performance to prevent a denial of a party's right in claiming payment for substantial performance.

By applying the doctrine of substantial performance in these types of situations the performing party is allowed to retain and enforce the rights that were conferred by the initial agreement. This is because the other party has still substantially received what was agreed to and are protected from the breach by being able to receive damages in the form of monetary compensation in order for make up for any losses that have arisen as a consequence of the contract not being totally and completely performed as agreed to between the parties.

23.3 Partial Performance

The principle of exact performance is advantageous to the party who is to receive the benefit of the contract being performed and which states that performance must be exact before payment can be made. In most situations and for commercial reality and viability, the parties generally agree to substitute the original agreement with a new agreement wherein one party agrees to accept partial performance in full satisfaction. Therefore, the courts have given rise to some exceptions and in some situations of partial performance, payment does not automatically follow unless the following applies in respect to the contract:

- the contract is divisible, that is, it can be divided up into its component parts and it is a question of the actual construction of the contract.
- where there has been a free and willing acceptance of partial performance by the party receiving the benefit;
- where the substantial performance has taken place; or
- the actions by the non-performing party prevent performance.

23.4 Divisible Contracts

A contract that is negotiated and entered into between parties may be required to ne 'entirely performed in full as agreed to or it can contain a clause that some performance and payment of the contract performed will be divided over a period of time (divisible or severable contracts). This means that the contract is a contract that is able to be divided into its component parts and that less than complete performance (reduced performance) will be permitted in some situations.

Essentially where the contract provides for it to be divided, it means that less than complete performance will be enough to confer rights on one of the parties especially in contracts for personal services such as an artist or builder to receive partial payment at various stages of the performance of the contract. Thus, where a contract is able to be divisible, it means that it would be possible for a party who could only partly perform the contract such as an artist or builder to seek payment for what has actually been completed on the basis of a *quantum meruit* (what he deserves). This is based on the implied promise under the contract to pay a reasonable sum for the work that was actually carried out and performed satisfactorily.

23.5 Discharge by Agreement

As contracts are created by agreement between the parties, the can also be changed, altered or even substituted by agreement. Accordingly, a discharge by agreement could be a mutual discharge, a release or waiver by one of the parties, a substituted agreement, merger or by accord and satisfaction. A contract can be created between parties from the beginning and also parties may make additional agreements in the future that varies the initial agreement or totally discharges the original contract. Irrespective of whatever agreement is made all of the usual requirements for a valid contract must exist in any other additional agreements, that is, the original can only be replaced by another valid and binding contract.

Accordingly, parties are free to terminate or cancel their contract by agreement. This might take the form of a termination provision in the contract itself or through a new and separate agreement and contract which must satisfy all of the essential elements as to the formation of a contract. There are a number of methods by which a cancellation, discharge or termination of the original agreement and contract can be effected by agreement and include the following:

- mutual discharge;
- release and waiver;
- substituted agreement (novation);
- accord and satisfaction; or
- merger.

23.5.1 Mutual Discharge

Under a mutual discharge both parties agree to abandon, discharge or release each other from the promises made under the original agreement. The contract at this point in time is still executory which means that as both parties still had something to perform. Under this type of discharge both parties give up or surrender their rights under the original contract, and it is this mutual discharge, which is called a bilateral discharge that forms the basis of the consideration for the discharge of contract.

23.5.2 Release

A release is similar to a waiver, but in this situation one party has performed their obligations under the contract and the other party has yet to complete his or her part of the contract. In this situation the contract is not executory as it is being performed. Thus in this situation, one party has performed their obligations under the contract and agrees to release the other party has not completed his contractual promises and is a unilateral discharge.

23.5.3 Waiver

This occurs where one party leads the other party to reasonably believe that while strict performance can still technically be demanded it will not be strictly insist upon.

23.5.4 Substituted Agreement (Novation)

The substitution of a new contract in the place of an existing contract between either the original parties or different parties.

23.5.5 Accord and Satisfaction

Where one party is in breach of the contract and the other party agrees to release that party from the breach by performance of another different promise.

23.5.6 Merger

In some situations a contract may be discharged by the actual operation of the law and one such example is by the operation of the principles of a merger. When a merger takes place by the operation of the law it will discharge the obligations of the contract under the contract. A merger arises where the parties to a lesser agreement, such as a simple contract, enter into a more significant and greater legal contract such as a formal contract or a deed on similar terms, then the lesser agreement is taken over by the greater agreement, which is legally enforceable.

23.6 Discharge for Breach of Contract

Breach of contract *may* give the non-breaching party a right to terminate a contract. The non-breaching party may terminate a contract for breach if a provision of the contract permits discharge for breach in the circumstances, for example, it might provide that in the event of failure to supply goods on a specific date the other party may terminate the contract.

A discharge for a breach of contract may also arise if the other party repudiates the contract, that is, renounces their obligations under it, for example, they say that they will not perform the contract. Also a discharge for breach will terminate a contract if the breach is sufficiently serious as minor or technical breaches will generally not allow the non-breaching party to terminate. In respect to a discharge of contract for a breach at law two categories of a breach exist and are an actual breach or an anticipated (anticipatory) breach.

23.6.1 Actual Breach

An actual breach of a term or terms such as a condition, warranty or intermediate (innominate) terms of a contract arises where one of the parties fails to perform a promise or promises made under the contract at the time when it had to be performed. A breach of condition enables the injured or innocent party to sue for damages and to terminate the contract unlike a breach of warranty which only allows the innocent party to sue for damages. Some terms that are in between conditions and warranties and referred to as intermediate or innominate terms may be treated as either a condition or a warranty depending on the seriousness of the consequences flowing from the actual breach as is illustrated by Figure 23.1 Remedies for Breach of Contract.

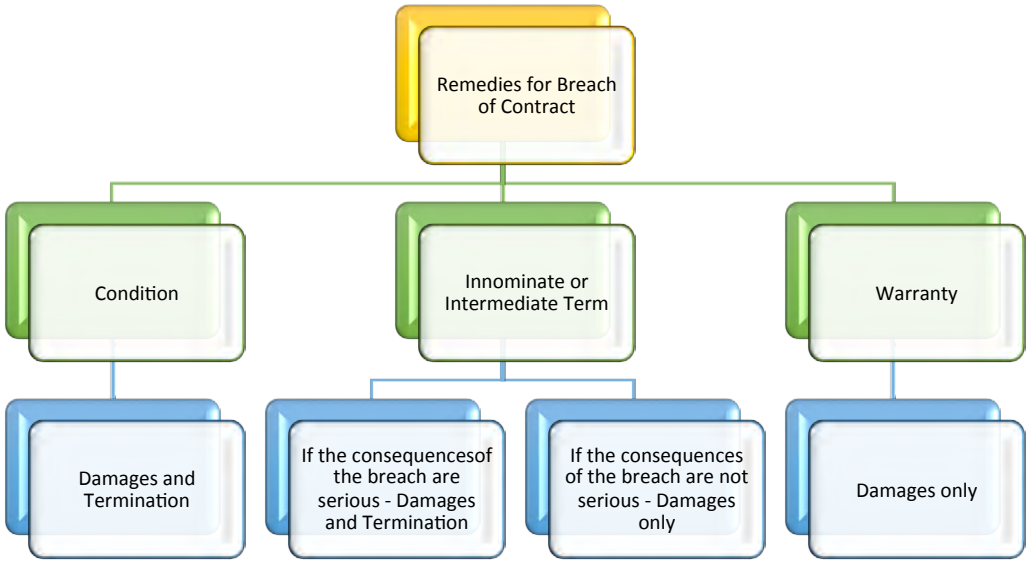


Figure 23.1 Remedies for Breach of Contract

An actual breach takes place because of the fact that one of the parties has failed to perform, the performance may have been defective or incomplete or if there is evidence to show that one of the main terms of the contract is inaccurate or misleading. If a promise is a vital term of the contact such as a condition, and this term has not been performed as promised then it will give rise to an actual breach which discharges the contract for non-performance. Accordingly, an actual breach of a condition operates to allow the innocent party to either treat the contract as at an end (terminated) and subsequently discharged and/or to sue for damages for any losses arising as a direct consequence of the breach.

23.6.2 Anticipatory Breach

If a party by words of conduct actually indicates an intention that he or she will not perform a future promise (executory) before it falls due for performance, is said to have committed an anticipated or anticipatory breach. Anticipated or anticipatory breaches can arise either by express intention or merely by implication. It should be mentioned that an actual or an anticipatory breach of a condition of a contract being a vital term of the contract as opposed to a warranty being a term of lesser importance, allows the innocent party to decide whether the terminate the contract or continue and/or sue for damages. If the innocent party does not want to sue for damages (monetary compensation) an order for specific performance can be sought from the Courts to compel performance of the contract, provided that this remedy is available. If on the other hand there is an actual or anticipatory breach of a warranty, being a term of lesser importance, than the innocent party is unable to terminate or discharge the contract and the innocent party has to seek an order for specific performance.

23.7 Discharge by Frustration

In some cases a contract will be brought to an end because of a supervening event that is beyond the control of the parties. The doctrine of frustration applies only in a limited range of circumstances and all of the four conditions for frustration must be satisfied before a contract can be discharged for frustration. In some situations, frustration is also, generally raised where the event renders performance of the contract something fundamentally different from what was initially anticipated by both of the parties. The courts are likely to be unsympathetic if the event could have been anticipated and therefore provided for by the parties in their contract. However, there are a number of categories of frustrating events that the Courts have held to constitute frustrating events.

23.7.1 Conditions for Frustration

The doctrine of frustration will not arise unless the following four conditions are fully satisfied:

- There must be a supervening event that significantly and radically changes the nature of the outstanding contractual rights and obligations;
- The event must not be caused by either party;
- The event must not have been reasonably contemplated by the parties at the time of the contract and the contract itself does not make any provision to deal with it; and
- In the new situation it would be unjust to hold the parties to the original contract.

23.7.2 Categories of Frustrating Events

There are a number of categories of frustrating events as illustrated by Table 23.1 Categories of Frustrating Events wherein the Courts have held that the contracts have been discharged by the operation of the doctrine of frustration and include:

- changes in the law;
- destruction of the subject matter;
- death or injury of party in contracts of personal service;
- failure of some important event; and
- government or external interventions.

Destruction of subject matter	**A contract may be impossible to complete it its subject matter is destroyed, that is damaged or without the interference of either party and as a result the contract is deemed to be frustrated.**
Death or illness of the parties	Contracts may become frustrated in a situation where one of parties who was contracted to perform a service but prior to completing that service, has died or suffered serious illness or disability making the contract impossible to be completed and is discharged.
Change in the Law	Changes in the law may take place after the formation of a contract and makes its actual performance illegal and the contract is frustrated and the parties are discharged from their obligations.
Common objective is no longer attainable	Certain circumstances or events may have taken place that require parties to form a contract, however, if those events to not actually take place without it being the fault of either party, then the contract is frustrated and the parties are discharged from their obligations.
Intervention by the Government	A contract may sometimes be declared as frustrated where there has been government intervention that causes the original terms of the contract to be substantially changed from what the parties had initially agreed to and intended to be bound.

Table 23.1 Categories of Frustration Events

Where frustration is established the contract is terminated automatically, that is the contract is discharged immediately, but only as to the future. This means that the contract is not void *ab initio,* that is, from the beginning, but is only void from the actual time and occurrence of the frustrating event that caused the contract to be terminated or discharged as it could no longer be performed. Thus, there is no option to either discharge or to perform the frustrated contract and at Common Law, the loss resulting from the termination lies where it falls, even though there are limited exceptions to that rule.

23.7.3 Principles on Frustration

Statutory modification to the principles of frustration, means that in most cases the harshness that might result from the rigid common law rule, that full performance of the contract is required, is avoided and lessened to enable payment to be made for services rendered, by the application of common law principles in respect to frustration such as:

- payment for work already completed before the frustrating event;
- prior payment for work or services not completed before the frustrating event;
- total failure of consideration may be a good defence against payment of unpaid money;
- total failure of consideration may allow the return of money paid prior to frustration.

Key Points

The key points in this module are:

MO1: Explaining the methods of Discharge or Termination of Contract: There are a number of methods of discharge or termination of a contract and they includes full performance, mutual agreement, expressed release or waiver, accord and satisfaction or by operation of law which makes the contract fully discharged.

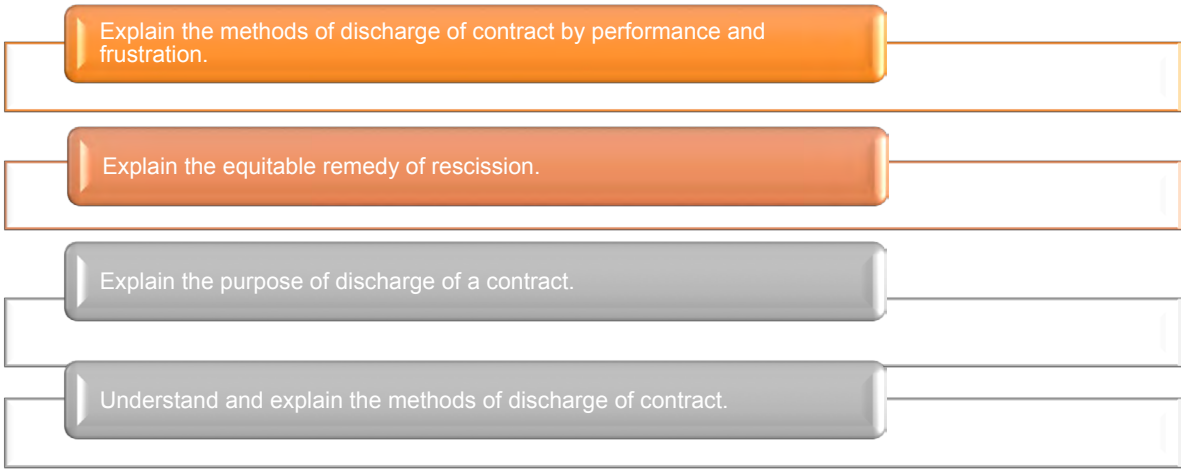
MO2: Explaining the difference between substantial and partial performance of contracts: Performance refers to the common form of discharging the right of the parties under the contract and refers to the situation when the parties to the contract have actually carried out the terms (the promises) of the contract. In some situations, substantial performance, acceptance of part performance and obstruction by the other party may also discharge the contract and is deemed to have been terminated.

MO3: Explaining when a contract is divisible and its link with *quantum meriut*: A divisible contract is one that is capable of being divided up into separate parts and is closely linked with the principle of *Quantum meriut,* which means as much as a person has earned or as much that a person deserved and only arises in situations of partial performance.

Module 24 Purpose of Discharge

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Duress: refers to threats of, or use of, force that deprives the innocent party of exercising their free will which lacks genuine consent in contracts.

Frustration: refers to the discharge of a contract that is rendered impossible of performance to due to unforeseen external factors.

Unconscionable conduct: refers to an unfair or unjust contract.

Undue Influence: refers to the use of influence or power by a stronger party over a weaker or vulnerable party.

Rescission: refers to an annulment of the contract making it *void ab initio* (void from the beginning).

Purpose of Discharge

A validly formed contract can be discharged in a variety of ways, such as for example, by performance, by breach or frustration. As discussed in those modules the actual method of discharge will directly influence the remedies that are available to any party who suffers damage as a consequence of the breach of contract. In everyday life people enter into contracts constantly and the foundation of the business world are the numerous and different types of commercial transactions that are entered into between parties. As a result of the complexity and diverse nature of contracts, each party to a contract needs to know, be aware of and understand the content and meaning of that contract, and that is when things go wrong or not as planned, each party needs to know what rights, obligations, liabilities and remedies exist under the law. The ever changing and evolving nature of commerce at both a local, national and international level as a consequence of, globalisation and doing business in the traditional sense and via the internet, means that there are constant challenges faced by people in business and commerce has led to constant changes to the common law and accordingly business must keep abreast of these changes and the different changes in both common law and statute law. Accordingly, a discharge occurs where the parties agree that no further performance is required of the obligations that are contained in the contract.

24.1 Contract Termination

A contract may be discharged or terminated at any time after it is formed either expressly or impliedly by one or both of the parties. In discharging or terminating the contract, there are a number of ways in this can occur and often it can be avoided by one party as a consequence of a vitiating factor such as unconscionable conduct, the contract may be terminated before it has been fully performed where there has been a breach by one party, or the contract may be performed to the satisfaction of the parties and it comes to an end.

In some situations, such as contracts for sale of goods, where the contract is discharged upon the payment of the price being the consideration, any rights arising under the contract can still exist after the conclusion of the sale and into the future. In respect to a contract for the sale of goods, the rights attached to the contract continues for longer after the transaction, because there is an implied term of the contract that the goods are of merchantable quality and this may not come to light until sometime after the transaction was concluded at the cash register at the time of the actual sale.

24.2 Termination by Innocent Party

The innocent party is entitled to terminate or discharge the contract in the following situations, where there has been:

- a breach of condition;
- a serious breach of an intermediate term;
- a repudiation of the contract; and
- an anticipatory breach of the whole contract or of a condition.

24.3 Methods of Discharge

Discharge of contract is when the contract actually ends and both parties are no longer obligated to perform anything stipulated within the agreement. A termination or a discharge of a contract can happen in the following various ways, namely by:

- actual performance;
- agreement;
- virtue of a term of the contract (condition precedent or condition subsequent);
- operation of law, such as merger or bankruptcy;
- frustration; and
- actual or anticipatory breach.

However, in general the methods of actually ending a contract are generally described as, termination or rescission.

24.4 Termination of Contract

When a contract is actually terminate, any future rights and obligations of all of the parties under the contract effectively come to an end and no longer exist. However, the actual contract itself still remains and is in existence which means that the some of the rights and liabilities that arose prior to termination may still be pursued by the parties. In this regard, where the courts deem it appropriate, damages will be assessed on the basis of the contract and some terms in the contract may still be enforceable by one of the parties. Thus, as a consequence of a termination the contract itself still exists, but what has terminated is the actual obligation of either party to perform any outstanding promises in the contract.

Accordingly, in respect to termination of contract, the law attempts to ascertain the situations or circumstances in which a contract may be discharged by events happening after its formation. In some situations, the law enables termination to be presumed such as where a clause of the contract operates to end the contract following the failure of a condition subsequent or because of frustration. On the other hand, there are some situations where the termination is not presumed or immediate such as where one party is in breach of the contract and the other gives notice of an actual or anticipatory breach of the contract and that the contract is effectively terminated because of that breach.

24.5 Rescission

In respect to the operation of rescission in bringing the contract to an end, it should be noted that rescission operates to extinguish the whole contract. As a result of rescission, neither party will then be bound by the contract in respect to any past or future rights and obligations.

Once a contract has been rescinded there is no longer an action for seeking monetary compensation in the form of damages. Rescission is normally available to a party where there was a lack of genuine consent as a result of one of the vitiating factors of duress, undue influence, unconscionable conduct, mistake or misrepresentation. In this situation, the rescinding party is actually entitled under law to act as if there had never been any contract and, the rescinded contract is deemed to be void *ab initio* (void from the beginning) as is illustrated by Figure 24.1 Equitable Remedy of Rescission.

Essentially the equitable remedy of rescission negates the contract either under the general principles of the common law or under statute law as a consequence of the vitiating factors of duress, undue influence and unconscionability which operate differently by both allow the contract to be terminated as is illustrated by Table 24.1.

Figure 24.1 Equitable Remedy of Rescission

	Duress	Undue Influence	Unconscionability
Definition	The defendant has *threatened or used violence* towards the plaintiff (his/her loved ones) to force them to enter into a contract.	The defendant used their influence (*position of power*) to force the plaintiff to enter into a contract. Stronger party is the Defendant. Weaker party is the Plaintiff.	The Defendant took some undue advantage of the plaintiff's *disability* resulting in an agreement that was unjust, unfair and inequitable. Stronger part is the Defendant. Weaker party is the Plaintiff.
Burden or Standard of Proof	The Plaintiff	Special relationships – the Defendant Other relationships – the Plaintiff	Plaintiff
Effect or Impact on Contract	Contract is voidable at the option of the Plaintiff	Contract is voidable at the option of the Plaintiff	Contract is voidable at the option of the Plaintiff Damages, Injunction and allowing the Plaintiff to avoid the contract.
Genuine Consent	Consent was not genuine as the Plaintiff entered into the contract because of Duress, Coercion and Intimidation.	Consent was not genuine as the Plaintiff entered into the contract because the Defendant used their influence and superior position of power to force them to accept the contract.	Consent was not genuine because the Plaintiff entered the contract because the Defendant took advantage of the Plaintiff's disability and disadvantage.

Table 24.1 Comparison of Duress, Undue Influence and Unconscionability

Key Points

The key points in this module are:

MO1: **Explaining the methods of discharge by performance and frustration:** Frustration is the discharge of a contract rendered impossible of performance because of the operation of external factors beyond the control and contemplation of the parties. The contract in this case can be discharged as a result of impossibility of performance due to an event unforeseen by either party, such as the destruction of the subject matter, change in the law, non-occurrence of a basic event, physical impossibility under a contract of personal service or a radical change in a state of affairs.

MO2: **Explaining the equitable remedy of rescission:** Rescission is an equitable remedy in which the court upholds the action of a party terminating a transaction, particularly a contract, which can be rescinded in this instance, by the affected party and makes the contract *ab initio*, by a vitiating factor that would make its enforcement unconscionable. At equity, if an act of rescission was valid, the party rescinding may rely on the valid rescission as a defence against an action seeking the equitable remedy of specific performance.

Modules 25 Remedies for Breach

Module Objectives

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

Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Causation: refers to the connection between the breach and the loss suffered by the plaintiff.

Damages: refers to the monetary compensation for the loss suffered by the plaintiff, which places the plaintiff back in the positon they would have been if the breach had not taken place.

Exemplary damages: refers to punitive or punishment damages.

Injunction: is a discretionary remedy available in equity that restrains or stops a party from doing something that is wrong or harmful to the plaintiff.

Liquidated damages: refers to an unfair or unjust contract.

Mitigation: refers to the steps taken by the plaintiff to mitigate (minimise) their loss under the contract.

Nominal Damages: occur when the plaintiff's rights have been infringed upon but they have not suffered any actual loss.

Ordinary Damages: refer to the amount of damages awarded by the court upon its determination of the actual loss suffered by the plaintiff as a direct result of the breach.

***Quantum meruit*:** arises in partial performance of a contract which can be divisible and means 'as much as a person has earned or as much as that person deserves'.

Specific Performance: is an equitable remedy that compels a person to perform their contractual obligations where damages would not be an adequate remedy for the breach of an agreement and it is not available for contracts of personal service.

Unliquidated Damages: refer to damages for a loss under the breach of contract, where the actual value of the loss cannot be accurately determined or exactly calculated and it is left up to the court.

Remedies for Breach

In this Module the remedies that are available for a breach of contract will be concentrated on, as in previous modules a discussion was made of the remedies that are available where a party's consent has already been 'vitiated' or affected by mistake, misrepresentation, duress, undue influence or unconscionable conduct. The term 'remedy' refers to the course of conduct, action or means that are available to an aggrieved, injured or innocent party at law or in equity for any harm or wrong that they have sustained through the actions of another or where a right has been breached or infringed.

Thus, in its broad sense a remedy is the means available by which a right is enforced or the infringement of a right is prevented, rectified or compensated. Remedies may be obtained by four main methods or ways, and include by the act of an injured person such as abatement in a private nuisance; by operation of law in the case of a lien over goods or property until payment is received for a service; by agreement between the parties as in the case of waiver or accord and satisfaction; or by judicial process such as a legal action against the party at fault or in default.

The normal civil remedies include damages, an injunction, and an order for specific performance or a declaration. The usual common law remedy in an action for damages arising under tort or breach of contract is damages, the aim of which is to put the plaintiff, as far as is possible, in the same position that they would have been in before the tort or breach of contract was committed.

25.1 Award of Damages

The law on remedies for breach of contract is contained in both the common law and under Statute to provide the particular remedy of damages and determining the award of damages. Irrespective of whether the plaintiff seeks some remedy or redress under the common law, or any of the jurisdictions company protection, and trade legislation it depends on whether the contract is regulated under the common law or under statute. Any claim that involves a breach of contract will generally be dealt with under the rules of common law for a breach of either a condition, warranty or an act of repudiation.

If the innocent party is to be awarded damages as well as a right to terminate the contract is normally dependant on the serious of the breach. Also, in respect to claims involving vitiating factors, such as misrepresentation, duress and undue influence the common law will apply in this instance and the normal remedy is the equitable remedy of rescission. In respect to contracts that involve the sale of goods or services they are normally regulated under statute, and they will provide a remedy under the relevant statute, based on the type of contract and the nature of the dispute, the parties to the dispute and the nature of the dispute. By looking at these three factors it will be determined whether the contract will be regulated under any provisions in respect to trade and fair trade, sales of goods or consumer protection legislation in providing a remedy to the injured or innocent party under the contract.

25.2 Remedy of Damages

In respect to remedies for breach of contract, the general rule is that damages are compensatory. An award of damages is a sum of money that is paid to the innocent party who has suffered a loss as a direct consequence of a breach. Damages are compensatory in that as far as is possible, the money awarded seeks or aims to put the innocent party in the same position that they would have been if the breach had not occurred and is fundamentally main aim or objective of an award of damages.

In contrast to the equitable remedy of rescission, damages are assessed and awarded at the time of the actual breach and do not provide any form of compensation for the services that have been consumed or used. Therefore, it is in this sense that damages are viewed as looking to the future because what they are aiming to do or want to actually achieve by an award of damages is to attempt to compensate the innocent party with a sum of money for the loss of the bargain under the contract that was entered into with the other defaulting party and must be reasonable and not too remote (remoteness of damage).

In this sense of looking to the future for the loss arising from the breach, the loss must have arisen naturally from the breach and was reasonably foreseeable. In this context, the loss is often referred to as loss of profits damages that is the expectation measure or expectation losses. This type of loss and the awarding of the appropriate estimated or expected future losses arise because the innocent party as a direct result of the breach (causation of damages) is denied the opportunity to crystallise or secure their profit because of the direct consequence of the defendant's breach of contract. This general principle in respect to the award or damages for a remedy for breach of contract is subject to the duty of the innocent party in all similar situations where they are confronted with a breach of contract to attempt to minimise or mitigate their losses.

25.3 Rules Regarding Award of Damages

In respect to the rules relating to the award of damages that must be complied with in ascertaining the amount or quantum of damages includes remoteness of damage; loss must be reasonably foreseeable; causation of damages and duty to mitigate loss, injury or harm discussed below.

25.3.1 Remoteness of Damages

This rule means that the damages to be awarded for a breach of contract to the innocent party must not be too remote. This means that, for damages to be awarded the actual consequences or loss resulting from the party's breach must have been reasonably foreseeable. Accordingly, if the loss suffered is not considered to be reasonable foreseeable applying an objective test of the reasonable person, then the view is that damages are too remote and that only losses that are reasonably foreseeable will be recovered.

25.3.2 Loss must be Reasonably Foreseeable

A loss that is reasonably foreseeable are those losses that arise naturally from the breach as well as losses arising in the reasonable contemplation of the parties at the time that the contract is made.

25.3.3 Causation of Damages

In respect of causation, only losses that are caused by the actual breach and are not too remote are recoverable. Losses that are not caused by the actual and direct consequence of the breach are not recoverable. The courts in this instance use the, but-for test in order to determine causation. In applying the 'but for' test, the courts consider the question of, 'but for the breach would the loss have actually occurred?' If in the given situation, the answer is yes, then the loss would be recoverable and the defendant would be liable, depending on the other issues of remoteness and foreseeability and the plaintiff's duty to mitigate.

25.3.4 Duty to Mitigate Loss

The law imposes a duty on the innocent party to take all reasonable steps to mitigate (lessen) their loss. If the innocent party does not take any measures or steps to mitigate their loss then the award of damages will be reduced accordingly.

25.4 Enforcement of Rights

The method by which an injured party enforces a right under a valid contract or corrects a loss by a breach of a term under the contract, is by way of 'remedy'. The remedies that are available to an injured party as a consequence of a breach of contract depends on the exact nature of the breach and the results will be different between the parties. Where there is a breach of contract, remedies are available to the innocent party who has suffered actual loss as a direct consequence of the breach. The remedies for a breach of contract vary significantly according to the seriousness or gravity of the breach. The usual remedy for a breach of contract is an award of damages, which is a common law remedy. A breach of contract arises where one of the parties fails to perform the whole or in part the obligations that were required under the contract.

However, if a remedy in the form of monetary compensation is not satisfactory or being pursued by the injured party, then the court may exercise its discretion and can order any of the several equitable remedies that are available in equity and which are based on the concept of fairness, including specific performance and injunction for contractual or threatened breach. The other discretionary remedies include restitution or *quantum meriut* among others as deemed appropriate, which are also based on the concept of justice and fairness. Where a breach of contract has occurred the non-breaching party is entitled to remedies; in particular, they are entitled to damages as a matter of right.

25.5 Classification of Remedies

The remedies that are available for a breach of contract are classified according to the Court in which they were developed, that is in either the common law courts or the courts of equity. Essentially, the plaintiff would be able to seek compensation (damages), enforce a right or obligation under the contract or seek a return of a benefit or enforce performance under the contract. Where there has been a breach of contract the innocent or injured party will seek a proper remedy depending on the nature of the breach of contract and what he or she wishes to achieve, that is either compel performance of the contract (specific performance order), order a return of any benefit that was obtained unjustly (restitution) or seek damages (monetary compensation) for the loss arising as a direct consequence of the breach or infringement of a right under the breached contract.

25.5.1 Monetary Compensation (Damages)

Under the common Law, compensation refers to an award of damages that is intended to compensate the plaintiff for the loss that was suffered as a direct result and consequence of the defendant's breach. However, in a claim for monetary compensation, the amount of damages claimed or awarded must not exceed the loss that is actually suffered by the innocent party as a consequence of the breach in the normal course of business and must not be too remote. Any loss that does not fall within either of these two categories will not give rise to an award of damages as it will be seen as being too remote and unforeseeable.

This means that the loss sustained is not seen as a loss that the offending party could have contemplated as a direct consequence of the breach and if a plaintiff still wishes to recover for the loss special notice must be provide to the defendant of the plaintiff's intention to sue for damages. When a court has established and determined the amount of damages to be awarded, the court will then have to decide how much damages (monetary compensation/money) will be adequate enough to compensate the injured party the plaintiff for the loss sustained as a direct result from the defendant's breach or negligence under the contract.

25.5.2 Enforcement by Specific Performance

Under equity law, in respect to the remedy of enforcement, the innocent or injured party may seek 'equitable and discretionary' orders from the court such as an order for specific performance or an injunction. Specific performance is an equitable remedy that is made by a court that compels the execution of a contract which requires some definite thing to be done before the transaction is deemed to be completed and totally performed and discharged with both of the parties' rights having been satisfied and met as defined by the terms of the contract. Specific performance is available from a court but it is subject to certain discretionary factors and is awarded in situations where the common law does not provide a remedy due to the nature of the plaintiff's claim and type of remedy sought, or where the common law remedies would be inadequate under the circumstances.

25.6 Order for Restitution

The law of restitution is a continually evolving area of law and can cover, and is applied in a number of different areas of private law including:

- Contract law
- Property law
- Trusts
- Torts
- Intellectual property

Restitution is primarily concerned with remedying a wrong which can be committed in a number of different ways thus depending on the nature of the wrong will give the innocent party some form of relief which in some situations will arise independently from the laws of restitution instead of the actual origins of the wrong itself. Restitution is a common law remedy where the party in breach is order to return a benefit to the other party in circumstances where retention would constitute an unjust enrichment. In respect to seeking an order for restitution, restoration must also be possible, and the main aim or objective or restitution, is to restore the plaintiff's original position prior to the breach.

The term restitution is also used to refer to extra-contractual remedies such as money had and actually received and also applies to *quantum meruit* (for as much as has been earned) in circumstances of part performance of the contract. A writ of restitution enables a defendant to have their property returned, if the order for its actual seizure has been reversed on appeal in court proceedings. In order to prevent or reverse unjust enrichment, the court can award restitutionary relief, by applying the concept of unjust enrichment which it provides a useful basis for ordering restitution in in some instances.

Key Points

The key points in this module are:

MO1: Explaining the remedies to an injured party for breach of contract under general common law: The main remedies an injured party for breach of contract under general common law is monetary compensation in the form of Damages. Damages, is the amount paid to an injured party for breach of a condition, warranty or intermediate term by the other party with the aim of putting the injured party back in the position they would have occupied if the contract had been performed as was originally intended. They will take the form of either being nominal, awarded by the court where it feels the injured party's legal rights have been infringed, but no actual loss has been suffered; ordinary, being the usual remedy for breach of contract; or exemplary where the court feels it should punish the party in default.

MO2: Explaining the principles upon which damages are decided: The courts will determine a number of principles upon which damages will be decided such as remoteness of damage and mitigation. Remoteness of damage – the court must consider whether the loss suffered by the injured party is a usual and reasonably direct consequence of the breach of contract. Was the loss suffered reasonably foreseeable as a consequence of the breach of contract? This is a question of fact. The defendant is liable for only those damages which could reasonably have been foreseen as a result of the breach and which arise in the usual or normal course of things. Mitigation, in addition to the questions of remoteness and measure, the law imposes a duty upon the person claiming damages (the injured party) to take all reasonable steps to reduce or minimise (mitigate) their loss. This is the duty of mitigation. If persons claiming damages fail to take these steps, the amount of damages they can expect to recover will be reduced. If the plaintiff is able to avoid a loss, damages will not be recoverable for the potential loss that the plaintiff may have suffered.

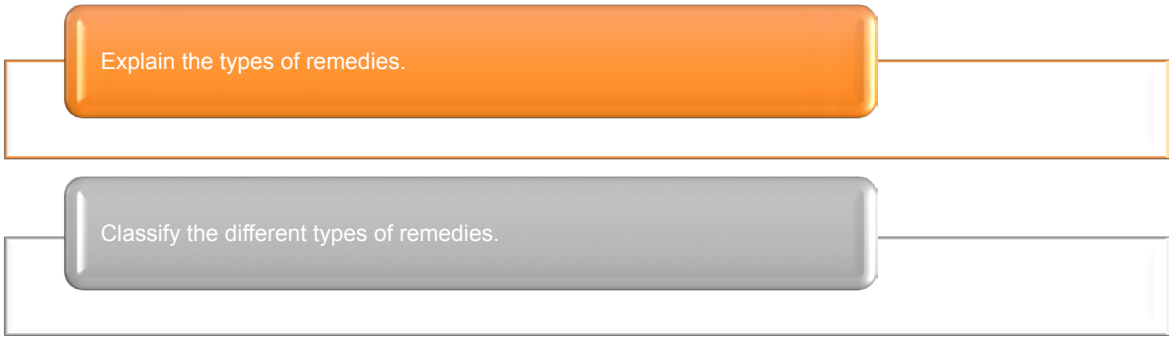
MO3: **Classifying the different types of damages:** There are a number of different types of damages. Liquidated damages are a fixed amount in the contract while unliquidated damages are awarded when a plaintiff is unable to assess precisely what should be the amount recoverable by way of damages, for example, for pain and suffering or disappointment. Here it is left to the court to determine the amount that should awarded. The type of damages awarded will be determined by the seriousness of the breach and whether the contract has specified the amount to be paid in the event of a breach. The main types or categories of damages are: Nominal damages are a token amount awarded when the court feels that the innocent party's rights have been infringed but they have suffered no actual loss; Ordinary or 'real' damages are the usual remedy in contract law. This is compensation in monetary terms for the loss suffered by the innocent party as a result of the breach. They take two forms: general damages which follow as a natural consequence from the breach; and special damages which have to be specially proved in court; Exemplary damages are generally not awarded in contract unless the court feels that it should punish the party in default. However, where the breach of contract has resulted in inconvenience, disappointment or discomfort to the innocent party, the courts have been prepared to award what are termed 'aggravated damages for non-pecuniary losses. Examples have included cases involving holiday packages where the facilities or accommodation have been misrepresented.

MO4: **Describing situations where an equitable remedy is applicable:** An equitable remedy of either an injunction or specific performance is applicable where the common law remedy of damages is not appropriate in the given situations. For instance, the remedy of specific performance is an equitable remedy, granted at the discretion of the court where it feels that damages would be an inadequate remedy that the defendant performed and carried out the promise that he or she has made under the contract. It is not granted as a matter of right to the person seeking the relief, but discretionary in the court. Also, in some situations, it must be possible for the court to be able to supervise the implementation of a contract, or it will not generally grant specific performance.

Module 26 Types of Remedies

Module Objectives

On the completion of this Module, you should be able to:



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Causation: refers to the connection between the breach and the loss suffered by the plaintiff.

Damages: refers to the monetary compensation for the loss suffered by the plaintiff, which places the plaintiff back in the positon they would have been if the breach had not taken place.

Exemplary damages: refers to punitive or punishment damages.

Injunction: is a discretionary remedy available in equity that restrains or stops a party from doing something that is wrong or harmful to the plaintiff.

Liquidated damages: refers to an unfair or unjust contract.

Mitigation: refers to the steps taken by the plaintiff to mitigate (minimise) their loss under the contract.

Nominal Damages: occur when the plaintiff's rights have been infringed upon but they have not suffered any actual loss.

Ordinary Damages: refer to the amount of damages awarded by the court upon its determination of the actual loss suffered by the plaintiff as a direct result of the breach.

***Quantum meruit*:** arises in partial performance of a contract which can be divisible and means 'as much as a person has earned or as much as that person deserves'.

Specific Performance: is an equitable remedy that compels a person to perform their contractual obligations where damages would not be an adequate remedy for the breach of an agreement and it is not available for contracts of personal service.

Unliquidated Damages: refer to damages for a loss under the breach of contract, where the actual value of the loss cannot be accurately determined or exactly calculated and it is left up to the court.

Types of Remedies

The only remedy under the general common law for a breach of contract is monetary compensation in the form of damages. It is clear that sometimes this remedy is appropriate in some cases and is inadequate and unsatisfactory in other situations, such as when you want to compel or force the other party to perform their part of the bargain or contract.

Thus, where money is not an appropriate remedy for the breach, the common law is not able to nor is it capable of giving a different solution that is fair. Accordingly, in these situations equity law will intervene with court orders that are intended to ensure that justice and equity is carried out and prevails in the decision and judgment made by the court. There are two equitable remedies that the court may award apart for damages for breach of contact. These two equitable remedies are the decree of specific performance and the injunction. These remedies are not awarded as of a right but are granted at the discretion of the court upon application by the injured or innocent party who sustained a loss under the contract as a direct consequence of the breach of contract.

26.1 Equitable Remedies

There are two main equitable remedies for breach of contract:

- Specific Performance; and
- Injunction.

Unlike the common law remedies which lie as of right to the injured party, both of these remedies are discretionary; and the court is not obliged to award them even where breach is established. Equitable damages may also be available in some specific cases.

26.1.2 Specific Performance

Specific performance is an order directing the breaching party to perform the contract in the way specified by the court. It will only be ordered if damages will not provide adequate compensation and will not be awarded in relation to contracts of personal service as the courts cannot determine whether the agreed promise had been properly performed, or any other situation where the contract would require constant supervision by the court. Specific performance is also not available where a contract has actually come to an end but where there were obligations under the contract that should have been performed during the term of the contract. In cases where common law damages are not an adequate remedy, especially in respect to contracts of land and contracts where the subject matter is valuable and unique, such as a rare piece of artwork, then the equitable remedy of specific performance would be the more suitable remedy as the Court holds that damages would be inadequate compensation in this situation.

26.1.3 Injunction

An injunction is based on equity and is a discretionary court order which has the power to restrain a person from doing a certain act such as breaching a contract and consist of a number of types of injunction. An injunction is a direction to a party not to do something, such as to not to persist with a contractual breach. In this context, an injunction is an order that restrains, that is, prohibits a party from breaching its contractual obligations and duties.

An injunction is not given in all situations, and is not given where, for example, the plaintiff has been guilty of delay, or the plaintiff is in breach of his or her legal obligations under the valid and legally enforceable contract. Sometimes, when a court does grant an Injunction, it is often criticised for having indirectly forced the party who is breaching the contract to specifically perform the contract even though the court had made no order with respect to specific performance.

However, where damages or specific performance is not an appropriate remedy, the court will grant an injunction and it may be:

- Prohibitory – preventing the contract from being actually breached;
- Mandatory – requiring the person who attempted to breach the contract to perform some contractual obligation under the contract;
- Interlocutory – where it freezes or puts a 'temporary hold' on the *status quo* between the parties until the dispute can be heard by the Court.

In applying for an injunction the applicant must convince and satisfy the court that they have a genuine and real interest in the matter and not merely frivolous or vexatious, and must provide primary evidence to support their application otherwise it will not be granted. As injunction operate to enforce a negative promise contained in an agreement, it can be enforced by the applicant via a court even if the contract is one that involves personal services and it can be an indirect way of ensuring performance of a contract of personal service in some exceptional situations.

26.2 Monetary Compensation (Damages)

Damages and liquidated claims are the common law remedies available following a breach of contract. Damages for breach of contract are viewed as a 'substitute' for performance – consequently, they are designed to put the plaintiff in the position they would have been in had the contract been performed properly. Punitive damages are not available. The loss claimed must not be too remote from the breach and the non-breaching party must do what is reasonable to reduce (mitigate) the damage they suffer. It should be noted that, damages might also be available for certain pre-contractual conduct, such as misleading conduct, and duress as well as in other areas, such as tort or pursuant to statute, but in this module the focus is mainly on damages for contractual breach. The main purpose of damages is to enable the injured or innocent party to receive monetary compensation (award of damages) from the part that was responsible for the breach of contract that caused the loss.

The main objective and purpose of damages is not to punish the breaching party. Instead the main objective of damages, is to put the injured or innocent party back in the position that they would have occupied if the contract had been properly performed on the basis of what had been intended and agreed to between the parties. In this context, damages are calculated on the basis of looking at what the position should have been between the parties if the contract had been properly performed from the beginning without any breach. In ascertaining damages, under contract law there are five legal principles on which the award of damages, being monetary compensation are applied, for the purpose of determining if the innocent or injured party will be able to recover anything as a result of the breach. These five legal principles that have to be answered affirmatively include:

- **Was there a breach?** – The injured party must first be able to establish that they may have been a breach of either a condition, a warranty or an intermediate term.
- **Causation** – The plaintiff must also be able to establish causation, that is, that the loss or damage would not have taken place 'but for' the breach of the defendant. If the causation of link is broken there is no action.
- **Remoteness of damage** – The court will only take into account those losses that are reasonably foreseeable and directly related to the contract and was a consequence of the actual breach and is a question of fact.

- **Amount of damages** – Innocent or injured parties must be able to show that they have suffered some loss if they are to recover any damages from the court in the form of either ordinary damages (awarded by the Court for the actual loss suffered as a result of the breach) or nominal damages (awarded for infringement of rights where no actual loss has been suffered).
- **Mitigation of damages** – The steps taken by the plaintiff to mitigated (minimise) his or her loss and if persons have failed to take these steps, the court will award reduced damages.

26.3 Ordinary or 'Real' Damages

Ordinary or 'real' damages are the usual remedy in contract law as is illustrated by Table 26.1 Different Types of Damage. They refer to the sum of money or quantum amount of monetary compensation that are awarded by a court in order to compensate the plaintiff for their loss. In this instance, the loss is a direct consequence of a breach of contract by the defendant. To succeed in this action, the loss that the plaintiff has suffered must be actually caused by the defendant's breach of contract, and the breach can relate to either a breach of warranty or a breach of condition.

When the court makes an award of ordinary or 'real' damages, the main purpose of objective of the monetary award is to compensate the plaintiff their loss. The award of ordinary damages is not designed to punish the defendant, but to return the plaintiff to the position that they would have been in if the breach at not occurred. Ordinary or 'real' damages are a means of compensation and they can take two forms: general damages – which follow as a general consequence of the breach; and special damages – which if they are to be claimed, have to be specially proved in court.

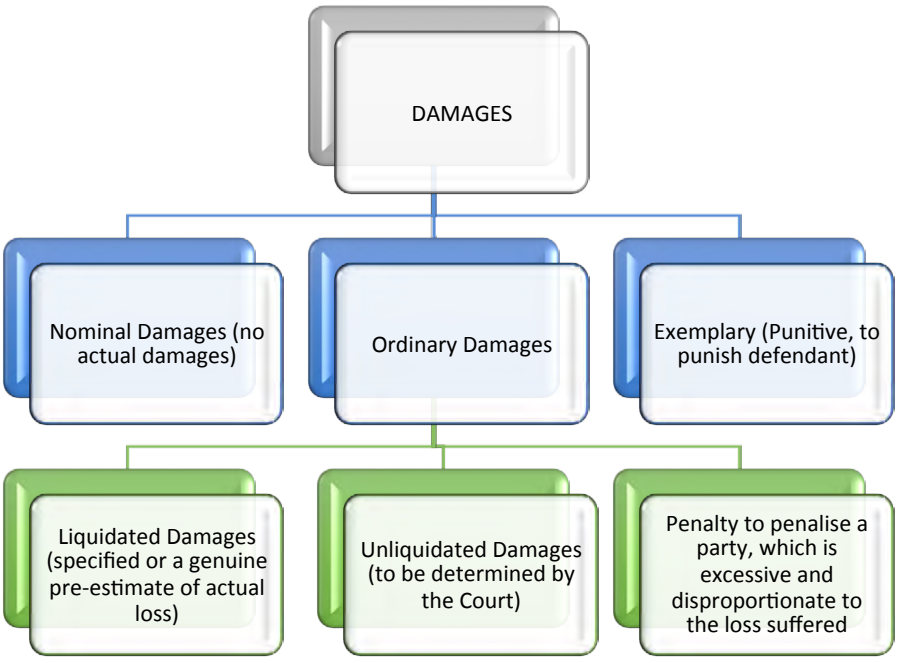


Table 26.1 Different Types of Damage

26.3.1 Nominal Damages

Nominal damage refers to damages that are awarded where no actual loss has been sustained but the innocent party's rights have been infringed. In this instance, nominal damages may be awarded by the court and they are generally 'nominal' or small amounts of money or awarded as a token sum by the court to the plaintiff for such infringement. When a court makes an award of nominal damages it means that it has been satisfied with the substantive nature of the claim by the plaintiff for the damages to be awarded. However, unless the plaintiff is able to provide sufficient evidence to support his claim of loss suffered by the defendant's breach for nominal damages, there is no guarantee that the court will rule in favour of the plaintiff by making an award of nominal damages.

26.3.2 Exemplary Damages

A court may award exemplary damages if it feels that the conduct of the defendant was unconscionable and caused the plaintiff to suffer a loss. An award of exemplary damages is awarded in order to act as a deterrent by the court to other potential defendants that the nature of the breach or breaches by the action or conduct of the defendant is unacceptable in accordance with prevailing community standards. In this regard exemplary damages may also be seen as a form of punishment for the defendant, and often arise more commonly in tortious actions for a civil wrong such as negligence. In respect to the award of exemplary damages under the tort of negligence, the court has deemed that an award of exemplary damages in this instance is justified especially where there is evidence of aggravating circumstances.

However, where the breach of contract has resulted in inconvenience, disappointment, discomfort or distress, to the innocent party, the courts have been prepared to award 'aggravated damages or non-pecuniary loss', such as for example cases involving holiday packages bought from travel operators where the facilities or accommodation and sightseeing have been misrepresented by the travel agent.

26.4 Other Remedies in Damages

The other remedies that may be available following contractual breach are for debt under the contract or penalty, liquidated damages or unliquidated damages. Liquidated damages will be available where a clause in the contract between the parties provides that a particular sum of money will be payable upon breach; provided that the sum specified does not constitute a 'penalty', the non-breaching party may sue for this 'liquidated' sum rather than for unliquidated Damages. A debt or penalty is very different from damages (liquidated or unliquidated). This is because it involves a claim for a sum of money that is due under the contract and is essential used to ensure performance.

It is, therefore, a liquidated sum, but is not in the form of a substitute remedy but is in fact a direct claim for a specified monetary amount owed under the contract in the event of a breach. Accordingly, under a breach of contract a plaintiff can sue for either liquidated or unliquidated damages, or both, for breach of a contract.

26.4.1 Liquidated Damages

Liquidated damages are sums of monetary compensation (damages) that are fixed in the contract. In the event of a breach of contract, the parties agree from the beginning of the contract what amount of money is to be award if there is a breach and the clause is referred to as an 'agreed damages' clause. The amount of damages agreed upon must be a genuine pre-estimate of the actual loss that will directly flow from the breach and it should include specific criteria on how the estimated pre-determined amount was calculated. In the event of a default under the contract, the defaulting party will have to pay that specified and pre-determined amount without the innocent party having to prove their actual damage or loss suffered that was a direct consequence of the breach. Liquidated damages are normally enforceable by a court provided that both parties have in fact intended and agreed to the specified amount or amounts under the contract.

However the courts are reluctant to enforce a contractual provision that amounts to a 'contractual debt' or 'penalty'. A penalty arises where the liquidated sum is disproportionate to the loss that is actually sustained by the plaintiff and it will not be enforced even if both parties have agreed to the provision. The reason for this is that the courts view penalty provisions with some suspicion and believe that there has not been true consent by the party in breach in these situations.

26.4.1 Unliquidated Damages

Unliquidated damages are awarded when a plaintiff is unable to assess precisely that amount of damages that should be recoverable. This normally arises, in situations where the action is in respect to pain, suffering and disappointment by the plaintiff. In these situations there is no exact amount mentioned in the contract and it is generally left up to the court or the jury to determine the amount of damages that should be awarded to the plaintiff in each particular circumstances.

26.4.2 Penalty

Unlike Liquidated damages which are normally enforceable by the court provided that both parties have agreed to the amount and there is genuine consent in the agreement, courts are reluctant to enforce a contractual provision that essentially amounts to a penalty or contractual debt. A penalty or contractual debt, is an amount specified in the contract not entirely agreed upon by one of the parties and acts as a form of security in order to ensure that terms under the contract will be performed, and it is essentially in the nature of a 'threat to ensure performance'. A penalty arises where the liquidated sum is disproportionate to the actual loss that is suffered by the injured party under the contracts, the courts will not enforce it as it is deemed that there has not been true consent by the party in breach.

In ascertaining the damages to be awarded and whether the amount of damages sought is a penalty or liquidated damages, for assistance the courts will look at the actual circumstances that gave rise to the contract in dispute and will look at the contract in its entirety by applying an objective test of the reasonable person and is a question of fact. In cases where the disputes is serious and the court has to determine the measure and type of damages to be awarded in any given case the courts will use the following tests:

- Liquidated damages must be a genuine pre-estimate of the loss suffered by the injured or innocent party; and
- A penalty is a sum that is far in excess of the actual loss suffered by the injured or innocent party.

Key Points

The key points in this module are:

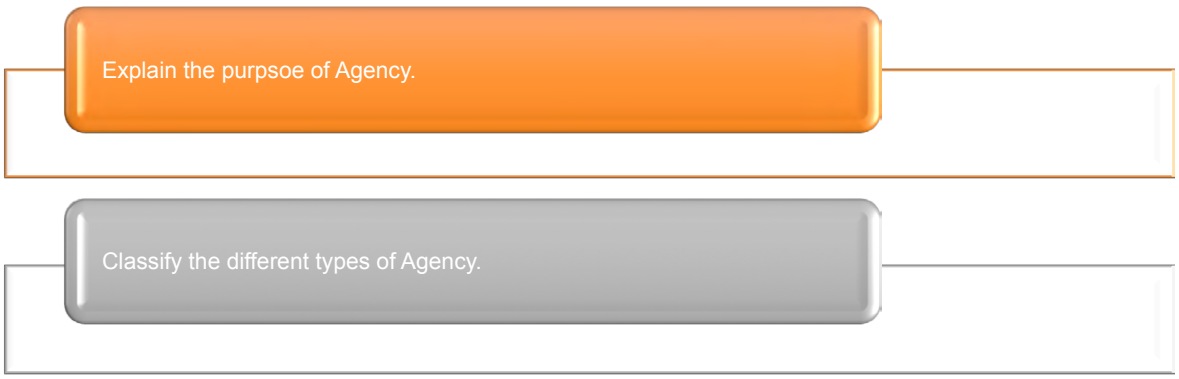
MO1: **Explaining the types of remedies:** The main remedies an injured party for breach of contract under general common law is monetary compensation in the form of Damages. There are also equitable remedies of an injunction or specific performance which may be awarded where it is not appropriate to award damages.

MO2: **Classification of the different types of damages:** The main types or categories of damages are: Nominal damages are a token amount awarded when the court feels that the innocent party's rights have been infringed but they have suffered no actual loss; Ordinary or 'real' damages are the usual remedy in contract law.

Module 27 Agency

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Agent: is a person who is employed by another person the Principal to act on his/her behalf in business dealings.

Employee: is a person that is employed under a contract of service and is subject to the authority and control of an employer in regard to the manner in which their work is to be carried out under the employment contract.

Estoppel: is a rule of law in equity that prevents a person from denying the truth of some statement that was formerly made by them in contractual negotiations, or even the existence of facts which by their words or conduct have given the impression to others that the statement made was true.

Factor: is a mercantile (commercial/merchant) agent, who has possession of the goods or the document of title to specific goods, of the principal and who can sell or pledge the goods which means that the principal will be bound by such sale or pledge by the action of the agent.

Ratification: refers to the act of adopting a contract entered into by another person who was not bound by it in the first place due to lack of authority of the person purporting to have actual authority.

Agency

In daily business and private commercial transactions, people are often and for commercial viability, efficiency and expediency are frequently represented by others in local, national and international commercial and business transactions. For instance, a person who is overseas may be represented by a nominated person, and a solicitor and accountant may be asked to represent their clients in respect to any commercial or business matter. In this context, a person that '*represents*' someone else is acting for an on behalf of that person (Agent) and depending on the circumstances can give rise to very different things depending on the authority vested or given to the person representing the other party (Principal) in commercial dealings with others (Third Parties). In essence Agency is the relationship that arises where one person is appointed to act as the representative of another.

There a many legal definitions of an Agent but the following definition clearly defines this legal relationship: *"An Agent is a person who has authority, either express or implied, to act for a Principal with the general object of bringing the Principal into legal relations with a Third Party".* Agency is an exception to the rule of doctrine of privity of contract, which generally states that only those persons who were immediate parties to a contract can obtain rights and liabilities under it. The reason for this exception is that it due to the complexity of commercial dealings it is often desirable and necessary for an individual to deal through others in commercial transactions such as bankers, brokers, manager, partners, company directors and secretaries. The word *Agent* is often used loosely in commerce, because a person is described as an agent even though he or she does not have the authority entrusted to an agent under an agency relationship, such as in a partnership.

27.1 Basis of Agency

From a legal perspective it is necessity to determine exactly what the representative is actually 'authorised' to do on behalf of the other party. This is not an easy task and accordingly the law of agency, that is the law involving the relationship between the principal and agent will be applied in order to determine the exact 'authority' of the representative in any commercial dealings which gives rise to an agency relationship where the agent creates or effects legal relations between another person, the principal and a third party.

The term "Agent" therefore, is used to describe different commercial relationships simple and complex which may or may not give rise to a definite agency relationship, which actually confers an 'authority' in a person, the agent to enter into a contract with a third party on behalf of another person the principal as authorised such as for example under a partnership or a Power of Attorney.

27.1.1 Agency Relationship

The main purpose of the agency relationship is to enable the agent to enter into and finalise a legally enforceable and binding contract between the principal and a third party without the agent undertaking any legal and binding obligations under that contract.

27.1.2 Fiduciary Relationship

The legal (fiduciary) relationship, based on trust, honesty and good faith that arises between a principal and an agent is called "Agency". The law of agency governs the situations where the principal will be legally bound by the acts of the authorised agent. However, in a legal sense, an agent is a person who is authorised, expressly or impliedly, to act for and on behalf of the principal and a 'third party' and consequently, the principal is then, bound in law by the acts of his agent as a direct result of the authority that is given to the agent, expressly, verbally or impliedly.

27.2 Defining Agency

There are many various definitions of "Agency" and "Agent" and there is no universally accepted definition. However, put simply, an *Agent* is a person who has the authority of another person referred to as the *Principal*, to enter into and create legal relations between the principal and a *Third Party* in conducting business for and on behalf of the principal.

Accordingly, this '*relationship*' like any legal relationship depends and is based on the creation of the authority that the agent has been given and vested with, as well as some direct and positive action done by the agent pursuant to the terms express or implied of that authority. There are three significant factors that arise from this agency and fiduciary relationship:

- Where an agent acts within his or her given authority, whether express, implied or apparent (ostensible), the agent can bind the principal to legally enforceable contracts with third parties and can impose on the principal a liability in tort to third parties;
- Where an agent acts within the given authority whether express or implied, the agent is able to obtain reimbursement and indemnity; and
- An agent must always act in the interests of the principal.

27.2.1 The Agency Relationship

In general the main function of an agent is to act for and on behalf of the principal in order to bring about or create a legally binding and enforceable contract between the Principal and the Third Party. In respect to discussions of agency law it is usual for 'P' to indicates and denotes the Principal or the person holding the role of Principal; 'A' indicates and denotes the Agent or person holding the role of the Agent and 'TP' indicates the Third Party, that is, the person dealing with A. As the relationships that are most commonly entered into through agents are in the nature of contracts, it is generally assumed that A, as Agent for P, purports (attempts) to make a contract with the TP for an on behalf of the P. Therefore, the three parties to an Agency relationship are: the Agent (A), the Principal (P) and a Third Party (TP) as is illustrated by Figure 27.1 Agency Relationship.

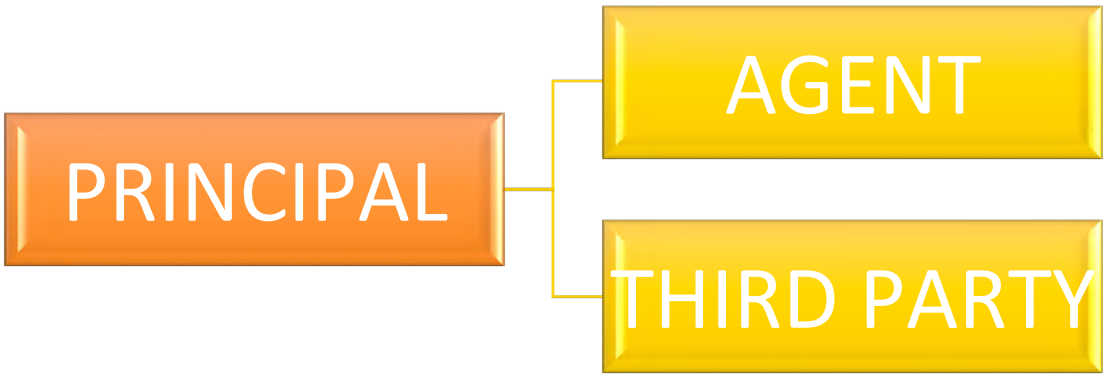


Figure 27.1 Agency Relationship

The agency relationship generally involves two relationships:

- The relationship that exists between the principal and agent which does not normally have to be a contract but generally is entered into a contract; and
- The relationship between the principal and third party which is an actual contract.

It should be noted that an agency is a form of "employment" in the widest sense of the word and is generally distinguished from the following two forms of employment:

- Employer/Independent Contractor – A contract for services.
- Employer/Employee – (also called master/servant) – A Contract of service.

27.2.2 The Agent

In a Legal sense, an agent is defined as a person with an authority or capacity to create or affect legal relations between a principal and a third party. Whether a relationship of agency exists between the principal and the agent does not depend on the actual terminology that is used by the parties, but instead on the nature of the authority that is conferred on the agent. In general terms, what a person may do himself or herself, such as enter in contracts, a person may do so legally by an duly appointed and authorised agent such as when selling real estate or motor vehicles or other commercial transactions. Accordingly, under this agency relationship the principal may be *vicariously* (indirectly) found to be responsible and liable for the any torts (civil wrongs) that are committed by the agent.

27.2.3 The Principal

A principal is a person who confers, vests or cloaks an agent with the authority to act on the person's behalf for the particular purpose or purposes of creating or giving rise to legal rights, duties and obligations with the principal and third parties.

27.2.4 The Third Party

A third party in a general sense is defined as a person who is not a principal to an agreement, proceeding or transaction. In a legal sense and in relation to agency, a person who is neither the principal nor the agent is referred to as the third party. The third party is usually the person brought into a legal relationship with the principal by the agent. A third party is also often referred to as the 'third person', 'outside party' or 'stranger'.

27.3 Creation of Agency

A state of agency or the agency relationship can be created by four different ways, namely by express agreement, by operation of law, by estoppel and by ratification. The creation of an agency presumes that authority has been granted and that is has arisen either through actual authority, by the operation of apparent (ostensible) authority or by the actions of a person (implied agency) as is illustrated by Figure 27.2 Agency Authority.

As a result an agency, being the relationship of principal and agent may arise and is created by one of the following ways:

- by express or implied agreement between the principal and the agent (actual authority);
- an Agency created by express agreement may usually be oral but there are some exceptions, especially in respect to the appointment of real estate agents which must be in writing; and
- Where there is an express agency agreement between the principal and the agent, the principal confers what is referred to as actual authority on the agent. This actual authority conferred on the agent by the principal may be either express authority which is expressed (written down) or implied authority which arises from the circumstances of the case and situation.

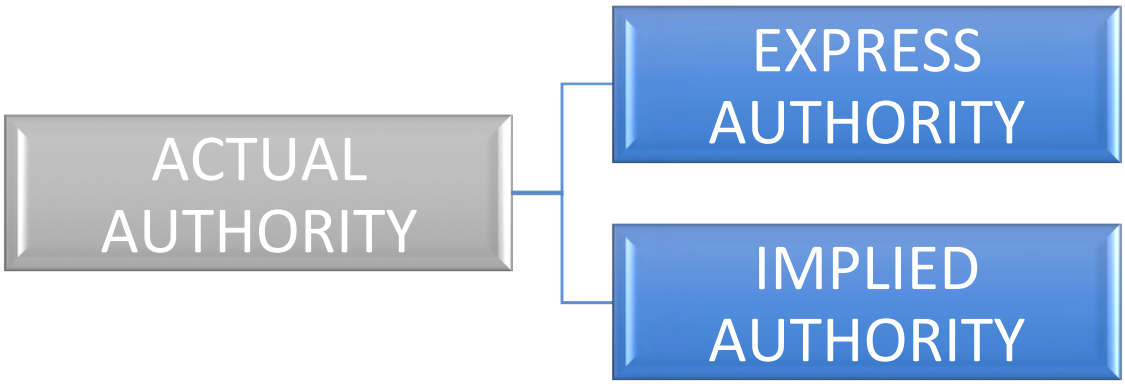


Figure 27.2 Agency Authority

27.3.1 Agency by Estoppel

Estoppel is a widely used legal concept in a variety of situations in commerce and business. Estoppel arises where the principal by words or conduct has created the appearance that the agent is in fact his agent although in reality, there is no agency relationship. Under these circumstances the principal may be stopped or prevented from denying that a particular person, for instance, Paul is his Agent. Thus, where an Agent by estoppel arises, the person in this case Paul, has what is referred to as 'ostensible authority which is also called "apparent authority" by the operation of the law, such as under the doctrine of necessity.

27.3.2 Other Agency Situations

An agency may also arise by operation of law in cases of cohabitation or necessity and by ratification of acts done by the agent without the principal's authority. An Agency may also operate retrospectively by the principal's ratification of the agent's unauthorised acts and this is often done by the principal's acquiescence (that is, acceptance) of the unauthorised act.

An agency by ratification can only arise under the following circumstances, where:

- the agent has contracted as agent, and not as principal;
- the agent must actually name the principal or sufficiently identify him. This is in contrast to the doctrine of undisclosed principal where the agent has actual authority. However, under an agency by ratification, prior to ratification of the unauthorised act by the principal the agent did not have actual authority;
- the principal must be in existence at the time of contracting;
- the principal must be able to enter into such a contract;
- the principal must have capacity both at the time of contract and at the date of ratification; and
- the principal must ratify all of the terms of the contract.

In respect to agency by ratification, the principal may ratify the unauthorised acts of the agent either expressly (orally or written) or impliedly (by conduct or prior dealings).

27.4 Classification of Agents

The common law and statute law recognises certain classifications of agents that operate in the business and commercial environment and the different legal aspects that arise between them depending on the authority or lack of authority that was granted to the agent.

In general most agents that operate within the legal business and commercial environment are classified as follows:

- Special Agents
- General Agents; and
- Universal Agents.

This classification of agents is important as it assists in determining the actual extent of that agent's authority of the nature and type of the authority that was actually granted to the agent by the principal. It also assist in determining the scope of the liability of the agent and or principal to third parties for subsequent breach of contracts and any loss arising from such contracts.

27.4.1 Special Agents

An Agent is described as a 'special agent' where the authority that is granted to that person is for an isolated and single task, and that the task for which the authority was given is not being performed as part of the agent's particular trade or profession.

27.4.2 General Agents

A 'general agent' is given the authorisation to act for the principal in either of the following two ways:

- a class of transactions of an extended or continuing nature; or
- one transaction only that is performed as part of the agent's actual trade, business or profession.

The authority of the general agent is generally very broad, and this type of agent has authority to do all the things that an agent in that particular trade, business or profession or position is normally entitled to perform. Under this type of agency it is up to the principal either expressly or impliedly to limit the authority of the general agent. However, even though the principal may limit the authority of the general agent, there may be problems associated with 'apparent or ostensible authority'. Some examples of general agents that operate in the business environment include mercantile agents, *del credere* agents and brokers.

27.4.3 Universal Agents

A 'universal agent' is authorised to act for an on behalf of the principal in all matters associated with the principal's business activities. The most common form of universal agent is the "Power of Attorney".

27.4.4 Power of Attorney

A power of attorney is the express authority that is given to one person to act in the place of another as agent. This authority is conferred or granted by under a legal instrument and usually under seal (formal contract) and described as the Power of Attorney.

Key Points

The key points in this module are:

MO1: **Explaining the purpose of an Agency:** The complexity of commercial dealings today means that it is often necessary for an individual to deal through others, such as bankers, brokers, auctioneers, factors, commission agents, managers, partners, company secretaries or solicitors, to mention but a few. Where these persons negotiate on behalf of individuals with third parties, they will be their agents. Agency is thus an exception to the rule of the doctrine of Privity of contract which states that only those persons who were immediate parties to a contract could acquire rights and liabilities under it. In an agency contract there is an extension, or grant, of the contractual powers of the principal to their agent for those purposes authorised in a prior agreement between them. The agency contract that has been created between the parties can be relied upon against, or by, third parties that have had dealings with the agent.

MO2: **Classifying the different types of Agency:** A *special or limited agent* is authorised by the principal to make a particular type of contract or to represent the principal in a particular transaction only. Whatever the type of transaction, it should not be in the ordinary course of the agent's business, but rather be seen as the agent acting in their private capacity. A *general agent* is authorised to make contracts of a certain class which are normal for such agents or to do some act for a principal who forms part of the ordinary course of business for the agent. A *universal agent* has power to do practically anything the principal can do and is usually appointed through a power of attorney. The reason for the classification is to determine the actual extent of an agent's authority.

Module 28 Agency in Business

Module Objectives

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

Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Agent: is a person who is employed by another person the Principal to act on his/her behalf in business dealings.

Employee: is a person that is employed under a contract of service and is subject to the authority and control of an employer in regard to the manner in which their work is to be carried out under the employment contract.

Estoppel: is a rule of law in equity that prevents a person from denying the truth of some statement that was formerly made by them in contractual negotiations, or even the existence of facts which by their words or conduct have given the impression to others that the statement made was true.

Factor: is a mercantile (commercial/merchant) agent, who has possession of the goods or the document of title to specific goods, of the principal and who can sell or pledge the goods which means that the principal will be bound by such sale or pledge by the action of the agent.

Ratification: refers to the act of adopting a contract entered into by another person who was not bound by it in the first place due to lack of authority of the person purporting to have actual authority.

Agency in Business

The common law on agency goes back to at least the 14th century in England and it is still very relevant in today's commercial environment, as commerce (business) could not operate in the manner that it does without the law of agency. Every day you are likely to enter into a contract with a person acting as Agent for another such as staff in shops, supermarkets and all retail outlets, counter staff at banks, insurance offices and post offices, travel agents, real estate agents, share brokers and company directors. There are many types of business relationships that exist in the commerce and business environment that enable business to be transacted between individuals and between individuals and business entities or structure such as partnerships, companies and associations.

In respect to the business and commercial environment, the term *'relationship'* is used to refer to a significant and enforceable by a court of law *legal relationship* which may exist between an individual and between an existing business entity. As an example, Peter and Paul are partners who wish to purchase a franchise which is a type of business structure. If Peter and Paul buy that franchise, their firm will be the *franchisee,* but the essence of the structure that they have entered into for themselves is and remains a partnership. Accordingly, the agency and franchise relationship are the two main and common types of relationship in the business and commercial environment, but the main focus will be on the agency relationship, its legal aspects and significance in businesses and commercial transactions.

28.1 Types of Agents in Business

In business there are number of different types of agents as well as 'specific' types of agents that operate within specific types of businesses and occupations. Regardless of which type of agency is used in order to create or affect a contract with a third party for the principal, there are a number of duties of an agent to his principal that arise out of the fiduciary relationship, common law and that have been codified in legislation. Apart from the three common classification of agents as special, general or universal agents which gives the agent full or limited authority to act on behalf of the principal there are a number of specific types of agents that operate within 'specific' types of business and occupations in the business and commercial environment.

28.2 Specific Types of Business Agents

There are a number of specific types of agents that allow various types of business and commercial transactions to take place on a daily basis from the sale of motor vehicles to auctions. These specific types of agents some of which are governed by common law and equity law as well as legislation are discussed below.

28.2.1 Mercantile Agents (Factor)

A "mercantile agent' or 'factor' is a person that sells good that have been entrusted to their possession or control. The most common forms of mercantile agents or factors are auctioneers and other person who sell goods on consignment as part of their trade or business and is in the usual and ordinary course of business. The activities of mercantile agents or factors are governed by various consumer protection legislation which generally allow mercantile agents who have possession of goods or documents of title with the owner' consent to pass good title to a bona fide purchaser even where the sale may be unauthorised.

28.2.2 *Del Credere* Agents – Level 2

A *del credere* agent sells goods entrusted to them but also for additional and generally high commission, will guarantee that they will be paid for by the agent, if the purchaser does not pay for the goods. Essentially this type of agent is similar to a contract of guarantee. The main advantage for a principal in using a *del credere* agent is that, the agent buy guaranteeing payment is being more careful with dealings with buyers, and may potentially avoid the possibility that buyers might avoid payment or go into bankruptcy. Even though the agent is taking a huge risk in respect to payment by the purchaser, the agent is compensated by the higher commission that is attached to this type of agency.

28.2.3 Brokers

A broker of which the most familiar and common type of broker is a stockbroker, is a general agent who buys and sells commodities for the principal, but is not entrusted with possession or control of the commodities or their documents of title. The main purpose of brokers is that they introduce the buyer and the seller who then contract directly with each other, for remuneration called 'brokerage' which is fixed on a percentage basis of the sale.

28.2.4 Partners

Every partner is the agent of the partnership when acting within the ordinary course of business of the partnership and binds his co-partners. A partnership is an example of a situation where the agency relationship is vital for the conduct of business and commerce and is governed by the law of agency as well as the common law rules and statutes, such as the *Partnership Acts*. Each partner in a partnership has the authority, unless it is expressly limited and made known to third parties, to make contracts, within the scope of the firm's business that are binding and enforceable on all the partners in the firm.

28.2.5 Auctioneers

An auctioneer is the authorised selling agent of either real property (land) or personal property (goods/ chattels) and the fall of the auctioneer's hammer denotes acceptance of the highest bid and the auctioneer becomes the agent of the purchaser for the purpose of the sale by auction. In this instance the auctioneer is accountable to the principal and has the duty to collect the purchase price from the buyer and if payment is not received is able to sue for it in the auctioneer's own name. A *lien* (legal hold) may be placed over any property of the principal. That is legally in the possession of the auctioneer until payment and proper expenses have been paid to the principal.

There are number situations which give rise to a relationship of principal and agent for the purposes of conducting business or affecting a contract for and on behalf of the principal with a third party. The other type of 'general' agent arising from the actual situation or business includes sub-agent, company directors, shipmaster, married women, commission agents, bankers and travel agents. As an example, in respect to banks, even though the relationship is normally one of debtor and creditor, sometimes an agency relationship arises such as the collection of cheques.

28.3 Duties of an Agent

The duties of an agent have two very important legal bases which cloaks or covers the agency relationship with extra special duties and includes a contractual basis and a *fiduciary* basis. As the agency relationship gives rise to special duties and obligations as between the principal and the agent and is based on the element of 'trust', it is commonly referred to as a "fiduciary relationship". The common law and equity law have also imposed a number of duties of an agent to his principal that recognise the "contractual relationship" between the principal and the agent.

28.4 Agent's *Fiduciary* Duties

An agent has the following *fiduciary* duties which arise from this special type of relationship to his principal to always:

- follow the principal's instructions otherwise the agent will be liable for the losses caused to the principal;
- act in person for and on behalf of the principal as authorised;
- act in the interests of the principal at all times;
- maintain confidentiality;
- make full disclosure to the principal of any potential or apparent conflicts of interest;
- not to make any secret profits or secret gains at the expense of the principal;
- take care of the principal's property; and
- keep separate accounts and to keep proper accounts and make these accounts available for inspection by the principal at any given time.

Essentially these duties ensure that while acting on the principal's behalf the agent acts honestly, with reasonable care and skill and in the best interests of the principal. Accordingly, the agent must at all times comply with the terms of the agency agreement and must follow the instructions of the Principal and the authority that is entrusted to the agent by the principal must not be exceeded.

28.5 Rights of an Agent

In respect to the rights of an agent in an agency relationship if there is no contract or the contract is silent on certain aspects and matters of the agency relationship, the law operates either expressly or impliedly, to give the agent certain rights as against the principal. The rights of an agent against the principal include the following, the:

- **Right to remuneration:** An agent is entitled to remuneration that is in accordance with the actual terms of the contract that gave rise to the agency relationship. The remuneration that is generally given to agents depends on the terms of the contract between the principal and the agent unless it is regulated by operation of law and if the principal refused to pay the agent the principal may be able to be sued for damages;
- **Right to indemnity and reimbursement:** An agent often incurs expenses in fulfilling the contract of agency and in the absence of any agreement to the contrary, the agent is entitled to reimbursement for the proper and reasonable expenses that were incurred while acting within the proper authority given to the Agent either expressly or impliedly by the principal. If an agent acts outside the scope of the authority or has incurred expenses negligently, or in an unlawful and unauthorised manner that the agent cannot be reimbursed or indemnified;
- **Right to a lien:** An agent has a right to retain possession of the principal's goods and documents until payment for the service and reimbursement of expenses incurred have been made. This right to retain possession is known as a '*lien*'. Under an agency relationship, an agent's lien is normally *particular lien* as opposed to a general lien, that is the right to possess any goods, as it only creates a right over the goods or documents that relate to a particular transaction; and
- **Right to a stoppage in transit:** Where the agent has bought goods on behalf of the principal or incurred a liability in order to pay for the goods that were purchased in the usual and ordinary course of business, the agent has a right of *stoppage in transit,* which allows the agent to stop the delivery of goods that were dispatched for the principal.

28.6 Liability of Agents to Third Parties

The primary function of an agent in the agency relationship is to bring the principal into legal relations with the third party, and once this is done it is usual for the agent to retire from the relationship. However, in some situations an agent may sometimes be liable to a third party even though they are not directly in a contractual relationship with the third party.

An agent may be deemed to be liable to a third party where, the:

- third party thinks that they are in fact dealing directly with the agent, and the agent has failed to disclose the existence of the principal (doctrine of undisclosed principal).
- agent has exceeded the scope of their authority either expressly or impliedly when dealing with a third party (being a breach of authority).
- agent commits a tort (civil wrong), such as negligence, misrepresentation, unconscionable conduct or misleading and deceptive conduct) when dealing with a third party (tortious liability).

28.7 Doctrine of Undisclosed Principal

The doctrine of undisclosed principal is where neither the existence nor even the name of the principal are disclosed. The third party in this instance may sue either the principal or the agent for breach of contract. However, once a third party has obtained judgment against either the principal or the agent, the third party is generally prevented from obtain judgement from the other party.

28.8 Breach of Authority

If the agent acts outside the scope of their express or implied authority, the third party may sue the agent for damages. In order to succeed in their action the third party has to prove that they have relied on any representations that were made by the agent regarding the agent's actual authority entrusted to them by the principal.

28.9 Agent's Tortious Liability

When a third party relies on a misrepresentation of an agent of if the agent acted in an oppressive, unconscionable, misleading or deceptive manner, the agent may be liable in tort for any harm, injury damage or loss. If the agent was acting within the scope of their actual authority at the time that the tort was committed then the principal may also be liable for any misstatements or misconduct by their agent.

28.10 Termination of Agency

The termination of the agency relationship in business may be effected by one of the following methods, by:

- agreement between the parties;
- revocation by the principal of the agent's Authority; and
- operation of law.

28.10.1 Agreement between the Parties

An agency relationship can be terminated by the parties in the following ways, by:

- performance of all terms and obligations under the agency agreement;
- agreement between the parties to rescind the agency agreement; and
- renunciation (denial) by the agent, except where the principal has given valuable consideration to support the agency agreement.

28.10.2 Revocation by the Principal

In some circumstances, a principal who terminates an agency, or revokes an agent's authority, or who limits the authority of the agent, may be *estopped* (stopped) from denying that there has been continued authority given to the agent unless reasonable steps are taken to give specific or general notice of the withdrawal of the agent's authority. One way of ensuring that once the agency relationship is actually terminated by the principal, that the agent is not 'deemed' to have authority and is totally removed is to give notice to all concerned parties of the termination of the agency.

28.10.3 Operation of Law

An agency relationship will be terminated by operation of law in the following situations:

- when a specific time has expired or where no time is specified, within a reasonable time;
- death or permanent disability of either the principal or the agent;
- one of the parties being declared insane or bankrupt;
- when the contract has been frustrated;
- when the purpose of the contract becomes illegal; and
- when the principal becomes an enemy alien.

Key Points

The key points in this module are:

MO1: **Explaining the link with Agency and Partnerships:** The complexity of commercial dealings today means that it is often necessary for an individual to deal through others, such as bankers, brokers, auctioneers, factors, commission agents, managers, partners, company secretaries or solicitors, to mention but a few. Where these persons negotiate on behalf of individuals with third parties, they will be their agents. Agency is thus an exception to the rule of the doctrine of Privity of contract which states that only those persons who were immediate parties to a contract could acquire rights and liabilities under it. In an agency contract there is an extension, or grant, of the contractual powers of the principal to their agent for those purposes authorised in a prior agreement between them. The agency contract that has been created between the parties can be relied upon against, or by, third parties that have had dealings with the agent.

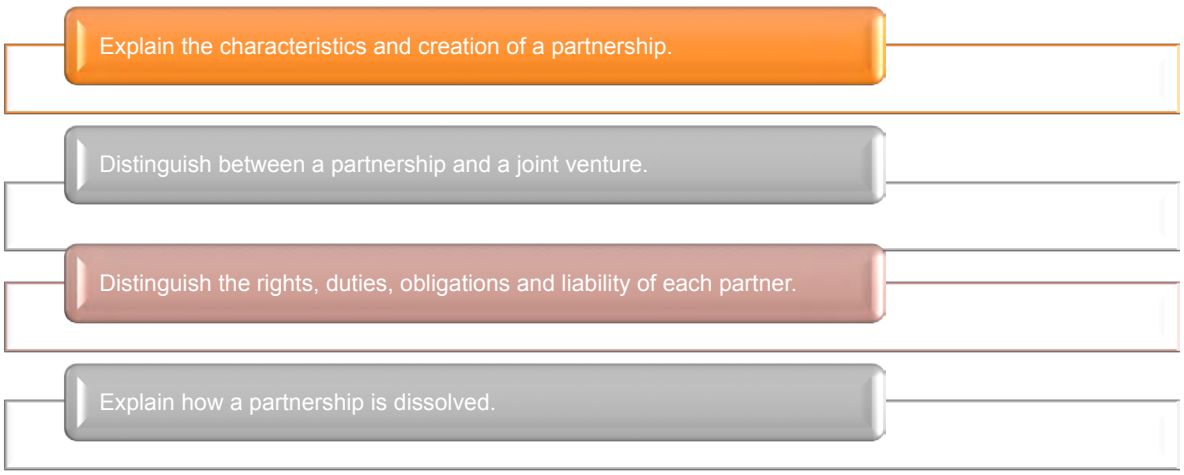
MO2: **Explaining the Agent's Duties the Principal and Liability to Third Parties:** An agency is a relationship whereby one person (the agent) is authorised by another (the principal) to do certain acts that affect the principal's legal rights and duties to third parties. For this reason an agent stands in a fiduciary relationship to the principal and owes special duties to the principal and is liable to third parties if he acts beyond the given authority either express or implied. A fiduciary relationship is based on trust therefore an agent must not use their position to make a personal gain. This principle is reflected in the broad general principle that an agent must always act in good faith and in the principal's interests. In particular an agent: must avoid any conflict of interest; must make full disclosure of any personal interests; must not make any secret profit; and must not accept any secret commissions.

MO3: **Explaining an Agent's Authority and Termination:** An agent's authority can be terminated in a number of ways. An agency agreement may be terminated by: Act of the parties through: mutual agreement; revocation of the agent's authority; withdrawal from the agency agreement by the agent (renunciation); acceptance of a secret commission (termination by the principal); completion of the agency; or expiration of the time the agency was to run. It can also be terminated by operation of law through: performance; lapse of time; death, insanity or bankruptcy of the principal or agent; or frustration.

Module 29 Partnerships and Companies

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the

Agent: is a person who is employed by another person the Principal to act on his/her behalf in business dealings.

Joint Venture: is a business arrangement of two or more people or entities entered in to for a one off (ad hoc) agreement for profit and normally used for exploration, mining, construction and entertainment ventures.

Partnership: is a relationship that subsists between two or more persons in common with a view of making a profit and gives rise to an agency relationship.

Partnership and Companies

This Module will briefly discuss the two main business entities or organisation that are used in conducting business in the marketplace, namely partnerships and companies. Generally, the maximum number of people permitted in a partnership is twenty, although for some professions there are rules that permit the numbers of the partners to exceed the maximum such as lawyers and accountants firms. A partnership can be formed by either express or implied agreement. An express agreement will be made either orally or in writing, while an implied agreement will result from the conduct of the parties.

29.1 Determining a Partnership

To determine whether a partnership exists, all the circumstances of the relationship between the parties must be examined in order to ascertain the following very important aspects:

- What the intention of the parties was;
- Whether or not there was a sharing of profits and losses accompanied by a state of agency;
- Whether each has a voice in the management of the business, so that it could be established whether agency has been created between the parties.

If these three questions are answered in the affirmative, there is no doubt that the arrangement is in fact a partnership. However, a person may receive a share of the profits in a variety of ways without necessarily being a partner but this is subject to negotiation and mutual agreement by the parties expressly or impliedly in respect to their business relationship. Additionally various *Partnership Acts* based on general common law principles of fairness and justice are generally framed negatively, which means that the courts in ascertaining the existence of a partnership or not, will generally look to factual issues and to which 'regard shall be had' in determining whether or not a partnership exists.

Generally the *Partnership Acts* of jurisdictions sets out a number of rules and criteria are used to assist the courts in deciding whether a partnership exists, such as:

- **Common ownership of property:** Common ownership of property, whether as joint tenants, tenants in common or part owners, is suggestive of a partnership, but of itself, does not necessarily mean that the common owners are in partnership;
- **Sharing of gross returns:** Sharing of gross returns does not of itself indicate a partnership; and
- **Sharing of profits:** The sharing of net profits creates a strong presumption that a partnership exists, but alone, it is not conclusive evidence.

29.2 Partnership Agreement

While there is no set statutory form for the creation of a partnership, parties are always advised to clearly and fully state the most important elements of the contract in written form. This is particularly important if the partners do not wish the provisions of any partnerships legislation to apply and is beneficial in cases of partnerships disputes and conflicts. Thereby, reducing a partnership agreement to writing introduces certainty into the arrangement between the parties, and helps to resolve disputes. In the event of a disagreement at some future date over the exact terms agreed to, the partnership agreement can be produced and the disputed terms examined.

29.3 Partnership Relationship to Outsiders

The relationship of partners to outsiders is very extensive and covers a wide range of contract and business transactions in the marketplace. Under contract law, each partner is liable jointly with the other partners for all debts and contractual obligations of the firm that were entered into for the purpose of carrying on the business of the firm (or partnership). Also, every partner is an *agent* of the firm and the other partners for the purpose of the business of the partnership. Thus, this means that any act of a partner done in *the usual course of partnership business* can bind the firm and their partners.

The authority of a partner can be considered using two specific criteria, the first dealing with the *actual authority* of the partners which states that every partner is an agent of the firm for the purposes of the partnership business. This actual authority may be *express* – that is, agreed between the partners, or *implied* from their conduct. The second criteria deals with the *apparent or ostensible authority* of the partners and only arises *where actual authority is lacking*.

In this instance, a third party, if they are to succeed against the firm (partnership), must establish:

- That the particular partner was acting within the scope of the business of the kind carried on by the firm;
- That the transaction was carried out in the usual way;
- That they (the third party) had no knowledge or belief of the lack of authority of the partner not to be able to bind the firm to the particular transaction in question.

Changes in partnerships, dissolutions and any special limitation of the authority of a partner are in most instances communicated to the general public and business community with public notification through the newspapers or any *Government publications*, so that those concerned are made aware of the changes or limitations to the firm or partnership.

29.4 Liability of Partners

Under the general contract law each partner is generally liable jointly (collectively) with the other partners for all the debts and contractual obligations of the firm or partnership. Where an action is brought against the firm, the partners are sued jointly and not individually. That is, while each partner is liable for the whole of the debts of a firm, the creditor is only entitled to bring one action against the members of the firm, because their liability is joint. Those partners who are not sued can be joined as co-defendants, or alternatively be asked to contribute a proportionate share of any damages awarded against the firm.

As only one action is allowed, partners not joined are discharged from liability by the first action and cannot be sued later. Where liability stems from a tortious act, to establish liability of co-partners, it must be shown that the act or omission was in the ordinary course of the business of the firm or, if the act or omission was not, that the act or omission was with the authority of the co-partners. Liability in such a case is joint (collective) *and* several (individual), entitling the plaintiff to sue *either* the firm or any of the partners. In the event of a judgement not being made against those being sued, the plaintiff can bring a further action against the remaining partners until they have recovered in full.

29.5 Partnership Dissolution

A Partnership generally may be dissolved in the following ways:

- **Action by the partners which is subject to any agreement between the partners, a partnership is dissolved:**
  - The expiration of a fixed term
  - If entered into for a single undertaking, by the termination of that undertaking; or
  - If entered into for an undefined time, by any partner giving substantial notice.
- **Operation of law**
  A partnership may be dissolved at the option of the other partners on the death or bankruptcy of a partner.

- **Illegality**
  A partnership is automatically dissolved by the occurrence of an event that renders the purpose of the partnership illegal or against public policy.

- **By the court**
  The above grounds can be used as a basis for the automatic dissolution of a partnership. In addition, a partner may apply to a court to have the partnership dissolved in the following circumstances:
  - insanity;
  - permanent incapacity (for example, paralysis as the result of a stroke);
  - when a partner has been guilty of conduct that in the opinion of the court is detrimental to the interests of the business;
  - where there is wilful or persistent breach of the partnership agreement;
  - when the partnership can be carried on only at a loss (of a permanent nature); and
  - whenever in any case circumstances have arisen that, in the opinion of the court, render it just and equitable that the partnership be dissolved, such as in deadlocks.

29.6 Corporations

A corporation is an artificial body created by law to carry out some form of enterprise, whether for profit or for some other purpose. A corporation is a separate legal entity and has a continuity of existence, irrespective of its management and members which may change from time to time. A corporation must operate through natural persons as it is an artificially created legal person. A Corporation that is incorporated is able to enter into contracts; own property and be a party to legal proceedings.

Historically there are two types of corporation:

- corporations sole: – which enabled property to be held on behalf of the Church by a church official such as a Bishop to be passed on to a successor of that position; and ownership of the property was vested in the corporation sole instead of the individual. Thus, a corporation sole is an artificial person representing successors to a particular position.
- corporations aggregate: which developed as an artificial legal person representing a group of individuals existing at the same time and individuals in this group could change without affecting the existence of the corporation.

Other possible types of companies are those companies formed at common law such as charter companies, that is created by royal charter such as companies created specifically by statute, example the Official Trustee in Bankruptcy and companies formed by registering under statute, such as the *Corporations Act* of legal jurisdictions.

29.6.1 Powers of a Company

Once a company is fully registered, then upon registration it is vested with and it has the legal capacity and powers of an individual (artificial legal person). Thus, the registered company has the legal capacity to enter into contracts, can sue and be sued, can hold property in its own name as well as to issue and cancel shares; issue debentures; grant options over unissued shares in the company; distribute company property to members; give security by charging uncalled capital and grant a floating charge over company property. The word 'company' or 'corporation' is applied to various kinds of association in which a number of persons finance a business enterprise or joint undertaking. It has a perpetual existence and is a separate legal entity.

29.6.2 Separate Legal Identity

A corporation once incorporated or register as an artificial legal person deemed to be separate from the persons who operate it, or are employed by it, as well as its shareholders, and is incorporated under the relevant corporation's legislation of jurisdictions.

This concept of separate legal entity of a company is the fundamental characteristic of a company that makes it distinct from other trading entities and from which the other significant characteristics flow. It means the company has its own legal existence and, therefore, rights and obligations completely separate and distinct from the people involved in it and laid the foundation of modern corporation's and established the concept of separate legal entity.

Specific characteristics of a company that flow as a result of the concept of separate legal entity are:

- limited liability, which means the shareholders' liability for the debts of the company are limited to the amount uncalled on those shares;
- perpetual succession, which means that regardless of who happens to be a shareholder or officer of the company at any particular point in time, the company continues to exist and retains its own character, rights and obligations;
- right to sue and be sued, which means that the company can institute and defend legal proceedings in its own name, thus avoiding complications that arise in partnerships where partners come and go, as well as protecting the shareholders and officers from being personally involved in the proceedings; and
- right to hold property, thus avoiding problems that might arise in a partnership as to who owns specific assets, as well as linking in with perpetual succession and being able to sue and be sued.

29.6.3 Limited Liability

Limited liability refers to the fact that shareholders are only liable for the amount of capital they promise to pay to purchase a share in a company. If the amount is fully paid then creditors cannot claim anything from the member, if the share is partly paid then the shareholder will be liable for the unpaid amount. Creditors can sue a company and take its assets to pay outstanding debts, but they cannot sue shareholders who have a separate legal entity to the company. A company has *'Ltd'* against its company name to indicate it gives limited liability to its members.

29.7 Fiduciary Duties of Directors

In equity, a director's relationship with the company is regarded as fiduciary in nature. This means that directors owe a duty of loyalty and a duty to act with reasonable care, skill and diligence in performing their functions on behalf of the company. Thus, the duty of loyalty covers four specific areas:

- good faith – directors are required to act in good faith for what they believe is for the benefit of the company as a whole;
- proper purpose – directors of a company are *fiduciary agents*, therefore a power conferred upon them cannot be exercised in order to obtain some private advantage. This can be breached even where they honestly believe their actions are in the best interests of the company;
- exercise discretion – as a general rule, directors cannot limit the exercise of their future discretions – for example, to vote in a certain way in the future at board meetings; and
- Conflicts of interest – because directors are *fiduciaries,* they must take care to avoid situations arising where their duties to the company and their personal duties are in conflict. This duty is strictly applied and extends to a position whereby directors should not even *appear* to be acting in their own interests.

Key Points

The key points in this module are:

MO1: **Explaining the characteristics and creation of a Partnership:** To determine whether a partnership exists or not, it is necessary to consider the following factors: What was the intention of the parties; To that end it is necessary to consider whether they satisfy the definition of a partnership; Is there carrying on of a business; Is there a carrying on of a business in common? Is the business being carried on with a view to profit; Is there a sharing of profits and losses accompanied by a state of agency; and does each person have a voice in the management of the business. The Partnership Acts (if any enacted in a country) will set out further common law rules, with regard to determining whether or not a partnership exists and these include consideration of factors such as tenancy, gross returns and profit sharing. The stated intention of the parties is not important. What the court looks at is what the parties must be taken to have intended, but also their conduct towards each other while carrying on the business

MO2: **Distinguishing between a Partnership and a Joint Venture:** A partnership is the relationship that subsists between two or more persons in common with a view to making a profit in a business partnership and is continuous. A joint venture is an association of persons for the purpose of a particular trading, commercial, mining or other financial undertaking or endeavour with a view to mutual profit, with each participant usually (but not necessarily) contributing property, money or skill and it is for a one off undertaking and there is no continuity as in a partnership relationship, Joint ventures are mainly used in industries such as, mining, property development, manufacturing, publishing, entertainment and share farming are often joint venture projects.

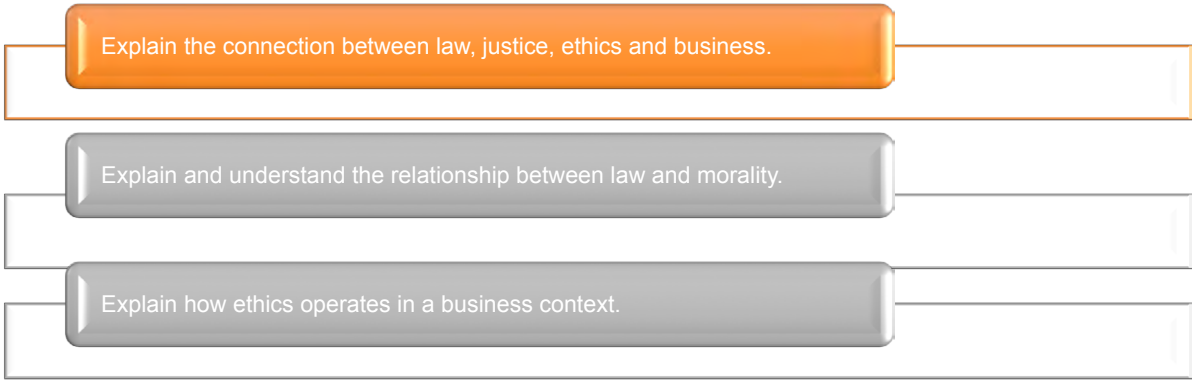
MO3: **Discussing the Rights, Duties, Obligations and Liability of each Partner:** Partners in a partnership have a number of right, duties, obligations and liability. For instance they have a duty to act in good faith and is required between the partners so that any matters affecting the partnership must be disclosed to all of them. The rights and duties of the partners amongst themselves are usually set out in their partnership agreement but if the partnership agreement is silent on any particular matter, or subject to any agreement to the contrary, then any Partnership legislation would set out a number of rules to determine the rights, duties and interests of partners in partnership property.

MO4: **Explaining how a Partnership is dissolved:** A partnership can be dissolved by: expiry of time; completion of purpose and activity; death, bankruptcy, if the business becomes unlawful and by the operation of the court.

Module 30 Ethics in Business

Module Objectives

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



Key Legal Terms

An understanding of the following legal terms will enable you to attain a better understanding of the topics covered in this module.

Corporate Culture: is an attitude, policy, rule or conduct that exists within a company or in the body corporate where the relevant corporate activities take place.

Ethical Considerations: refers to the personal conduct of going beyond self-interest when reaching a corporate or business decision.

Ethical Investing: refers to the ethical investment by companies that operate morally and ethically based on the context of corporate social responsibility and providing social and environmental benefits.

Ethical Judgment: is a judgment that is applied to everyone in similar situations.

Ethical Opinion: is an opinion that is concerned with personal behaviour in business or commerce and with establishing codes of conduct and practice in how people should behave.

Ethics: is a system of principles that relate to morals, moral questions and acting in a morally correct and honourable way.

Morals: are linked with Ethics and are concerned with the distinction between what is right and what is wrong in society or business.

Organisational Integrity: is based on the self-regulation of an organisation in accordance with a formal set of guiding principles.

Ethics in Business

Ethics is described as a way of thinking about what is morally right, appropriate and acceptable in society and it plays a vital and significant role in the business and commercial environment and is linked with law and morality. Ethics in Business and its link with 'morals', 'social justice' and corporate social responsibility' has been evolving for a long time and has gained momentum and more importance since the late 1990s. Business ethics has emerged as a distinct and high-profile area of corporate concern and academic interest worldwide and has impacted on global business internationally in a visible way in the late 1980s and 1990s as a result of high profile corporate collapses such as Enron and Arthur Anderson in the United States, HIH, Quintex and One-Tel in Australia. In respect to the relationship between Law and Morality an aspect that has significantly become very important in recent times is the relationship between business law and Ethics.

It is interesting to note that within the legal environment preference is given to discussing Ethics and its direct link with business instead of 'morals' and is referred to as 'business ethics'. In any discussion on ethics in business the specific focus is on the accounting and auditing profession. There are four main areas of ethics and business and any discussion in this area looks at ethical theories and applied ethics, including the nature of ethics and ethical decision-making; overview of business ethics and its relationship with corporate governance and social responsibility; an understanding of how ethics affects businesses, organisations and professions and corporate codes of conduct.

30.1 Law and Morality

In respect to ascertaining the meaning of ethics within any given society and its link with law and morals, it is clear that any law regardless of how it is defined and understood is relative (ethical and legal relativism) and applicable to their time and respective society and that they are constantly changing. This means that at any given point in time, laws as defined reflect the specific attitudes, values and norms of the society in which it exists. It should be noted that what is, and will be acceptable in one society may not be acceptable in another society. This means that any entity wanting to do business in a particular society or culture must be cognisant of those inherent values, standards and norms and must abide by them when contemplating and doing business. In respect to the context of the law and morality, the law will no doubt change and will continue to change in order to correspond with changing social values of any culture and society.

30.2 Defining Law

There is no clear definition of 'Law', but it is determined by each individuals moral, political, religious and ethical views. The meaning and definition of law at any given point in time is also influenced by the culture and society. Law is simply defined as a set of rules that have been developed over long periods of time. These laws are seen as regulating people's interactions with one another based on established values and standards of accepted conduct between individuals and between individuals and government.

These sets of rules which are accepted and enacted as law are generally enforceable by the courts through fines, imprisonment or both. Business law with which this module is concerned with the application of ethics to business has evolved over the years as a mechanism that is used to regulate and preserve economic and commercial interests, endeavours and enterprises locally, nationally and internationally. Business law essentially comprises and consists of rules that establish and determine the rights, duties and obligations of those persons who are engaged in commercial of business activities.

People are involved in commercial and business transactions every day in the normal and ordinary course of negotiating agreements which often lead to contracts, even though they do not often realise the particular lets of laws and other legal implications that arise by, for example, having the intention to enter into contracts. Ultimately, the law in the context of 'business law' maintains a balance between the interests of those individuals in business and responds to the needs of individuals as well as the needs of manufactures, retailers, buyers and consumers.

In this regard, and in the commercial sense, law acts as a regulator of business transactions and accordingly applies the legal rules and principles in respect to various branches of private law such as contract law, consumer law, competition law, company law and finance law. In this context of business and commerce, Law also applies to provide some legal framework and is applied on a daily basis. The law in this 'business' sense operates to regulate the business structures and various types of entities used in commerce and business, such as companies, partnerships, joint ventures and franchises.

30.3 Justice and the Law

In the legal domain and when discussing the concept of 'justice' and its link with 'law', another concept that is very closely linked with law is 'justice'. The term 'justice' is a very vague concept and very hard to define universally. However, in its simplest sense, 'justice' is defined as meaning 'that which is right of fair' and is linked to established values, norms and standards of behaviour that are acceptable by its members at any given point in time.

Justice is classified as being either 'social justice', 'moral justice' or 'legal justice' within society depending on the particular situation and circumstances in which it is applied. These types of 'justice' are aimed at serving different functions and purposes and operate individually in some instances or together depending on the particular situation and context in which the term is actually applied.

30.4 Morals and Ethics

Morals are concerned with distinguishing between what is right and wrong. Ethics on the other hand relate to aspects of consideration, judgments and opinions in applying a given set, standard or level or morals in a society collectively or by an individual. In essence, ethics relate to morals of an individual or society, as well as the way in which moral issues and questions are applied and treated as well as acting in a morally correct and honourable way, with honesty, fairness, respect, integrity and good faith.

As a consequence of this link between morals and ethics, the consideration of Ethics itself actually goes beyond self-serving interest in reaching a decision. An ethical judgment is one that is seen to apply to everyone in similar circumstances and not only any particular individual or members of any given society. In respect to this link between morals and ethics an ethical judgement is one that can be seen to apply to everyone in similar circumstances and not only to a particular individual.

Ethical opinions are concerned with behaviour and with establishing way in which people should behave. In this regard ethical opinions and decisions must be well reasoned in accordance with the sets of values and must not just be self-serving or personal preferences which is not an ethical reason for acting in a particular manner. Also, giving the appearance of acting ethically to enhance the interests of a particular business is not ethical business conduct. Consequently, as a result of this very important link between morals and ethics, a business in its normal and ordinary course of doing business will adopt an ethical approach for the following beneficial reasons:

- that the marketplace will eventually punish unethical behaviour; and
- governments will very often legislate to protect consumers and to control trading and commerce, such as the various consumer protection and trade legislation which operate to prohibit a number of anti-competitive conduct and behaviour in the marketplace.

30.5 Impact of Ethics on Business

Acting ethically involves acting in morally and correct manner and there has been increased discussion and focus on the importance of ethical issues in business and referred to as business ethics, as well as the focus on the link between law, ethics and morals arose as a result of the excesses of the 1980s and the late 1990s. The 1987 stock market crash for example greatly affected the United States, and Australia in the same way as other western economies that experiences market crashes. It also highlighted the link between the law and morality and the need for ethics in business. As a result of such financial and economic crisis, people and government attempt to find the reasons or causes for such the devastating events to business, individuals and the wider community. Sometimes there are global factors and forces that impact on market crashes, but often any internal problems within trading jurisdictions will make it necessary for the government and regulators of those jurisdictions, such as the Securities Exchange in the United States and the Australian Securities and Investments Commission in Australia to examine business practices and corporate culture that may have contributed to the downfall of the share market as well as small and large companies.

Managers and professionals in business make decisions of a legal nature every day, yet they do not always understand or have access to current knowledge in business law. They are constantly required to enter into formal and informal agreements and transactions in a wide range of business situations. These agreements and transactions can have legal implications, not only for their organisation but also for themselves. Indeed, there is an increasing trend in the law to make managers personally liable for breaches of the law by their organisation. Responsible managers therefore need to be aware of the importance of minimising legal risk. This benefits not only their organisation but also the manager by reducing their exposure to penalties and fines under the law. Managers who recognise that managing legal risk should be a normal and important part of their approach to their management duties need also to improve their knowledge by keeping up with changes to business and commercial Law.

30.6 Business Ethics

Ethics especially business ethics is fundamental to any discussion on morals. Ethics is concerned with the philosophy behind doing the right and wrong thing as members of society. Ethics is directly linked with morals which form the basis of the law and its application in a fair, just and equitable manner. In general the study of Ethics is concerned with the standards or values that are influenced by society's moral or religious beliefs. Apart from this, ethics in its wider sense and application refers to examining how an individual might act in a given situation, such as in trade, commerce or business. Ethics is also a way of determining the appropriate conduct to be applied in a situation and in ascertaining what has to be done in that situation and in what acceptable manner by given standards, morals and values of the society at any given time. In this regard it is clear that there are definite links between morals and ethics (business ethics) as well as law and morality. In essence these three ideals and basis of the rule of law which underpins acting in a just and fair manner are vital to all areas of society especially in business and commerce.

30.7 Ethics in a Business Context

Businesses that operate in the modern business and commercial world are often faced with various and complex choices or decisions to make on a regular daily basis. These choices or decisions may bring the interests of a number of parties to a particular contract being negotiated or the wider community into conflict with the particular commercial or business venture which are often based on ethical considerations. Accordingly, in the business and commercial context there are often conflicts between the interests of shareholders, the interests of creditors, the law and the wider community concepts and accepted standards of right and wrong.

These conflicts are not just confined to the personal values of the parties involved in the transaction when making personal decisions, but are also part of doing business each day and therefore are also part of business life. Everyday people in business and commerce have to make decisions that affect the actual and normal business operations such as: the allocation of resources, investment, the hiring and firing of employees, dealing with customers, creditors and members of the public. For example, in in the 1980s there were a number of global corporate collapses that have highlighted the need for sustained and continued ethical issues for company directors, entrepreneurs and regulators to adhere to ethical principles, based on morals as well as fairness and justice when doing business. Consequently, in the normal and ordinary course of doing business, there are a number of situations which clearly raise issues of ethical conduct and behaviour.

The following are examples of business situations that give rise to important ethical issues:

- Insider Trading
- Giving and Receiving Gifts
- Conflict between commercial interest and social utility
- Conflict of Interest
- Unconscionable contracts and conduct in business
- Misuse of Limited Liability of a company
- Tax Evasion/Tax Havens

30.8 Unconscionable Conduct in Business

In respect to ethical behaviour in business and commerce there are a number of important legislation such as for example in Australia, the *Corporations Act* 2001 and the *Australian Consumer Law* 2010 (Cth). These statutes within the Australian jurisdiction, are very significant and their main aim and objective is the protection of consumers in the marketplace when doing business with individual or corporations by taking action against corporate and other business entities in the marketplace in respect to a number of vitiating factors in business contracts which effectively operate to discharge or terminate the contract.

30.9 Sources of Business Ethics

Business does not operate in isolation and it is part of the wider community and is also subject to the laws of the various jurisdictions in which it operates. These laws are a reflection of the moral values and accepted standards or conduct and behaviour of the particular State or society in which it operates. Ethical behaviour does not just mean to just acting legally or acing morally in accordance with a set of specific rules but it is winder and it requires consideration to be made of the interest of various different groups by a particular business decision or conduct.

In this regard the sources of influence which a business considers when determining the manner in which the business should conduct its operations are significant. These sources of influence impacting on ethics in business includes the Law, community expectations, duty owed to shareholders, internal policies and a concern for the business to have a good reputation in the wider community. Businesses will refer to these sources which influence ethics in business as ultimately, businesses realise that behaving ethically is actually good business sense and will lead to prosperous and long-term success.

30.10 Law as a Source of Ethics

In order to determine how a business should act when conducting business in its usual and normal course of trading, it is necessary to ascertain what types of behaviour and conduct in business are legal. Even though there is a direct link between illegal behaviour and conduct and unethical behaviour and conduct, it is clear that not all illegal acts are regarded as unethical. However, sometimes a conduct that is legal may be viewed by some members of society as being unethical or immoral.

By setting a standard of conduct and defining the values by which a business operates, business ethics is significant as it can assist in determining the proper behaviour or course of conduct in a particular business or commercial situation. Accordingly, within the parameters of the law, when doing business, business ethics is described as a form of applied ethics that tend to operate as a means of examining moral or ethical problems and consideration that arise in business and also provides a guide to the proper course of conduct and behaviour in the particular circumstance.

In this regard ethics and its link to business law, ensures that business conducts itself in an ethical and proper manner that upholds its values, complies with the law and considers the interests of each party with whom it has a direct relationship such as shareholders, employees, customers, creditors and the wider community.

30.11 Corporate Governance and Ethics

Personal ethics should always be reflected in the business environment and it is seen as an essential requirement. However, not every person that is employed trade, business or commerce will have the same view or concept regarding the application of ethical morals and considerations and in maintaining organisational integrity that is based on specific sets of codes of conduct or practice in the particular industry.

For example, if a business does not have a uniform and consistent approach to ethical issues and applying them when doing business, it may run the risk of the decision makers acting only in accordance with legal requirements and ignoring ethical considerations. In ignoring ethical considerations management tends to operate in an unethical manner by, whereby the interests of the business are placed first before any others. Thus, if personal ethics conflict with the approach of management which puts the interests of the company before any others then the employees are placed in a position of conflict with the interest of the business and ethical and moral considerations.

30.12 Corporations and Ethics

Company directors and other company officers have general common law duty to act ethically and honestly by ensuring good corporate governance and organisational integrity. Both the common law and relevant corporation's legislation impose duties on the directors of companies which are essentially guides to ethical conduct and behaviour. They are significant and important in respect to business ethics as they impose general duties of trust and honesty as well as a duty to act legally.

The duties of company directors at common law and legislation that are linked to ethics, morals and justice include:-

- A duty to act in good faith;
- A duty to act with care and diligence;
- A duty not to use a position improperly;
- A duty to act honestly; and
- A duty to avoid conflicts of interest

Generally, the duties that are owed to the company as a whole and not the shareholders, employees or with the exception of creditors to any other individual or the wider community. The duties of the directors have been narrowly interpreted in the context of commercial and business practice, because the Courts have historically been reluctant to interfere with the affairs of a company.

30.13 Ethics and Organisational Integrity

In organisations company executives are reluctant to admit responsibility for any wrongful actions of an individual or individual employed by the company or other type of business organisation. Many see the wrongful act entered into or conducted by that individual or individuals are being an isolated incident within the knowledge or approval of the organisation. Regardless of this view, unethical business practices that are perpetrated by an individual or individuals in a company, often involve the assistance and cooperation of other members and reflect the values, beliefs and behaviour patterns of the culture that is inherent and operating within the particular company.

Organisational integrity therefore, is based on the idea or notion of self-regulation of the organisation in order to attain and maintain ethical business practices by applying and operating within a formal set of pre-determined guiding principles. In the establishment of an integrity program within a business organisation, ethical values and considerations are always involved in assisting to establish organisational systems and decision-making processes which support and search for business opportunities that are based on ethics, morals and justice.

Essentially, the integrity programs of an organisation often consists of a corporate code of conduct, training compliance in respect to the legal obligations of the organisation, effective reporting and control systems to alleviate breaches and enable reporting and investigations to be easily conducted and proper auditing in order to ensure that the integrity program is being complied with effectively and by abiding with ethical considerations. It is not enough just to have a corporate code of conduct which provides a source of ethics to ensure organisational integrity. Accordingly there must be a mechanism to ensure compliance and accountability or responsibility to ensure that ethical integrity is attained and maintained within an organisation within the organisations corporate culture. The law recognises and acknowledges that corporate culture plays a significant role in applying the principle of 'corporate accountability or responsibility'.

30.14 Codes of Conduct and Ethics

In response the ensuring ethical business practices, organisations have developed a set of ethical rules or guidelines that may assist employees of an organisation. However, the development of an ethical corporate culture will provide the employees of an organisation more than just an awareness and knowledge of the rules or codes of conduct of the organisation. Ethical corporate culture will give the employees of the organisation an idea and appreciation of what is the right and ethical thing to do within the culture of the business. By applying ethical corporate culture, it will mean long term benefits not just for the employees and the organisations but the wider community affected by the impact of the particular organisations business decisions hence its link with corporate social responsibility by businesses. Apart from directors observing their corporate duties for good corporate governance their duties also involves acting in the best interest of the organisations by not just applying a code of conduct but also a code of ethics which supports organisational integrity within the organisation. Business may see having a code of ethics as simply good business practice, based on the notion that any business that has a good reputation and a reputation built on honesty, fairness and integrity is likely to attract and retain the best employees and customers.

However, a code of ethics is not the same as a code of conduct, even though they may have stemmed from the same concept of fairness and honesty and a real and genuine desire to act in a proper manner in business. Essentially, a code of conduct is a set rules that are to be followed in specific circumstances and they will also guide and direct employees how to act and behave in those specific circumstances, for example, to:

- disclose to a supervisor any offer of a gift or benefit in connection with the decision making for the business;
- always advertise employment opportunities in a non-discriminatory way; or
- reveal any conflict between an employee's financial interest and that of the business.

In most circumstances, a code of conduct will actually be in line with and in accordance with a code of ethics of the business, but codes of conduct are more legally and practically focused in respect to specific business and industry needs and best practice. Codes of ethics on the other hand are developed to guide employees in the decision making process, and are applied and developed to prevent actual or possible conflicts of interests. Codes of ethics are used to assist employees to understand their obligations and responsibilities when discharging their daily tasks and in carrying out business for the organisation in the normal and ordinary course of activities.

30.15 Corporate Social Responsibility

In this regard the notion or idea of ethical corporate culture is directly linked with corporate social responsibility. This is because organisations are examining not just ethical issues but also environmental issues and the impact that their business whether manufacturing, agricultural or mining will have on the wider community. Accordingly as part of the corporate codes of conduct organisations are developing policies of sustainable business development based on the notion of ethical conduct, behaviour and investing and corporate social responsibility. In respect to the emergence of corporate social responsibility and its importance to be practices by businesses the United Nations (UN) has established a voluntary framework for businesses that are committed to responsible and ethical business practices and investing.

The compact called the United Nations Global Compact recognises that business development, trade and investment are essential for prosperity and peace in the wider business community and internationally. This has arisen as it has been seen that business development and the philosophy of making profits before anything else has in some instances resulted in the exploitation of indigenous people, destruction of the environment, inequality of income and corruption of government regimes.

Key Points

The key points in this module are:

MO1: Explaining the connection between Law, Justice, Ethics and Business: There is a connection nowadays between law, justice, ethics and business since, due to the increase of corporate social responsibility, Business ethics is about how business affairs are conducted. In business, acting ethically involves acting in a morally correct and honourable way. The attitude that 'making profits is all that matters' and 'as long as it is legal it is all right' is gradually being replaced by a more ethical approach. While ethical business conduct may impose a cost on business, that cost may be offset by an increase in public confidence. Community attitudes and standards are changing. The community is now very aware of business matters and their consequences, particularly those which impact on individual members of the community and has given impetus to increased corporate social responsibility. If a business does not adopt acceptable ethical standards, then Parliament or the State is likely to impose standards that must be complied with in the business environment.

MO2: **Explaining and understanding the Relationship between Law and Morality:** There is a direct relationship between law and morality and in this context law that is based on the ethical relativism that is that law is relative to their time and their society. Thus acting ethically involves acting in a morally correct and honourable way. The attitude that "making profits is all that matters" and "as long as it is legal it is all right" in business is gradually being replaced by a more ethical and moral approach. While ethical business conduct may impose a cost on business, that cost may be offset by an increase in public confidence. The public at large, the government and shareholders, all have an interest in the behaviour of businesses. A business might adopt an ethical approach for two reasons, namely, the market will ultimately punish unethical behaviour and governments may legislate to protect consumers and to control trading.

MO3: **Explaining how Ethics operates in a Business Context:** The socially responsible investor considers whether or not the investment is ethical, this means judging a company or institution primarily on its products and services as well as socially responsible governance practices. The usual guidelines for determining which company to invest in, include considerations such as is the company associated with the business includes in its goals and objectives, environmental protection; pollution control; conservation of resources; health and safety of the workplace and the community and ethical employment policies.

Table of Cases

Adams v Lindsell (1818) 106 ER 250.
Amalgamated Society of Engineers V Adelaide Steamship Co (1920) 28 CLR 129
Associated Newspapers Ltd v Bancks (1951) 83 CLR 322

Balmain New Ferry Co Ltd v Robertson (1906) 4 CLR 379
Balfour v Balfour [1919] 2 ALL ER 760
Blythe v Birmingham Waterworks Co (1895) 11 Exch 781
Bolton v Stone [1951] AC 850
Brownsea Haven Properties Ltd v Poole Cooperation [1958] CH 574
Butler Machine Tool Co Ltd v Ex-Cell-O Corp [*(England) Ltd* [1979] 1 WLR 401;
Byrne and Co v Van Tienhoven (1880) 5 CPD 344

Carlill v Carbolic Smokeball Co [1893] 1 QB 256
Causer v Brown [1952] VLR 1
Central London Property Trust Ltd v High Trees House Ltd [1947] KB 130
Clarke v Dunraven [1897] AC 59
Commonweatlh v Verwayen (1990) 95 ALR 321
Con-Stan Industries (1986) 160 CLR 226
Couldrey v Bartrum (1881) 19 CH 394
Coulls v Bagot's Executor and Trustee Co Ltd (1967) 119 CLR 460
Curtis v Chemical Cleaning and Dyeing Co [*1951*] *1 KB 805*

Daly v General Steam Navigation Co Ltd [1979] 1 Lloyds Rep 257
Darlington Futures Ltd v Delco Australia Pty Ltd (1986) 68 ALR 385
de Lassalle v Guildford [1901] 2 KB 215
Dickinson v Dodds (1876) 2 Ch D 463
Donoghue v Stevenson [1932] AC 562
Dunlop Pneumatic Tye Co Ltd v Selfridges [1915]

Eastwood v Kenyon (1840) 11 AD & E1 348
Ellul v Oakes (1972) 3 SASR 377
Entores Ltd v Myles Far East Corp [1955] 2 QB 327

Felthouse v Bindley (1862) 11 CBNS 869
Foakes v Beer (1884) 9 App Cas 605
Fonq v Cilli 11 FLR 495

Glasbrook Bros Ltd v Glamorgan County Council [*1925*] *AC 270*
Goldsborough Mort & Co Ltd v Quinn (1910) 1 QB 674.
Gray v Pearson (1857) 6HLC61; 10 ER 1216
Grainger and Sons v Gough [1896] AC 325
Giumelli v Giumelli (1999) 190 CLR 101

Hartley v Ponsonby (1857) 7E & B 872
Hay (or Bourhill) v Young [1943] AC 92
Head v Tattersall (1871) LR 7 Exch 7
Heydon's Case (1584) 3 CO Rep 7a; 76 ER 637
Hillas & Co Ltd v Arcos Ltd (1932) 147 LT 503
Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd [1962] 1 All ER 474
Hopkins v Tanqueray (1854) 15 CB 130
Hutton v Warren (1836) 1 M& W 466

Jaensch v Coffey (1984) 155 CLR 549
Jones v Vernon's Pools Ltd [1939] 2 All ER 626
Jorden v Money (1854) 5 HL Cas 185

Legione v Hateley (1983) 152 CLR 406

Masters v Cameron (1954) 91 CLR 353
Mercantile Union Guarantee Corp v Ball [1937] 2 KB 498
Merritt v Merritt [1970] ALL ER 760
Mills v Mee King (1990) 169 CLR 214

Oceanic Sun Line Special Shipping Co Inc v Fay (1988) 62 ALJR 389
Olley v Marlborough Court Ltd [*1949*] *1 KB 532*
Overseas Tankship (UK) Ltd v Morts Dock & Engineering Co Ltd (The Wagon Mound No 1) [1961] AC 388

Paris v Stepney Borough Council [1951] AC 367
Perre v Apand [1999] HCA 36
Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd [*1953*] *1 QB 401*
Pinnel's Case (1602) 77 ER 23
Powell v Kempton Park Racecourse Co Ltd [1899] AC 143
Pym v Campbell (1856) 6 E and B 370

Ramsgate Victoria Co Ltd v Montefiore (1866) LR 1 Exch 109
Rann v Hughes (1778) 7 Term Rep 350; (1778) 101ER 1014
Re Bolton; Ex parte Beane (1987) 162 CLR 514
R v Clarke (1927) 40 VLR 227
R Leslie Ltd v Sheill [1914] 3 KB 607
Roberts v Gray [1913] 1 KB 520
Roscorla v Thomas (1842) 2 QB 851
Rose & Frank Company v JR Crompton & Bros Ltd [1925] AC 445
Routeledge v Grant (1828) 4 Bing 653

Smith v Hughes [1960] 1 WLR 830.
Stilck v Myrick (1809) 2 Camp 317
Sydney City Council v West (1965) 114 CLR 481

The Moorcock (1889) 14 PD 64
Thomas v Thomas (1842) 2 QB 851

Van Den Esschert (1854) 15 CB 130

Walton Stores (Interstate) Ltd v Maher (1988) 164 CLR 387
White v Bluett (1853) 23 LJ Ex 36
Wigan v Edwards (1973) ALR 497

Table of Statutes

Acts Interpretation Acts [*federal jurisdictions*]

Consumer Protection Legislation [*federal jurisdictions*]
Corporations Law Legislation [*federal jurisdictions*]

Electronic Transactions Acts [*federal jurisdictions*]

Fair Trading Acts [*states jurisdictions*]

States Interpretations Acts [*state jurisdictions*]
Statute of Frauds 1677 (Imp)
Statutes of Limitations

Trade Practices Legislation [*federal jurisdictions*]

Vienna Convention for International Sales of Goods [*states and federal jurisdictions*]

Web Links and Resources

1. *Introduction Business Law* <http://www.youtube.com/watch?v=viyVBPvFFkQ>

2. *Business Law: The Sources of Contract Law* <http://www.youtube.com/watch?v=CFfGisDx6nQ&feature=channel>

3. The modern Tort of Negligence, which is one of the best known Torts was developed from the decision of the House of Lords in *Donoghue v Stevenson* [1932] AC 562 (the famous 'Snail in the ginger beer bottle' case) and which is reported at <http://www.bailii.org/cgi-bin/markup.cgi?doc=uk/cases/UKHL/1931/3.html&query=Donoghue%20v%20Stevenson>

4. *Hedley Byrne and Co Ltd v Heller and Partners* [1964] AC 465 House of Lords [Negligence – Duty of care in respect of advice] <http://www.bailii.org/cgi-bin/markup.cgi?doc=uk/cases/UKHL/1963/4.html&query=hedley%20byrne%20and%20co%20ltd%20%20and%20%20heller%20and%20partners>

5. International Business and Contract Law: <http://www.youtube.com/watch?v=bEy9DrlqUaY>

6. Statutory Interpretation: <http://www.youtube.com/watch?v=taabCvla10E&feature=related>

7. English Legal System: <http://www.youtube.com/watch?v=i0XSz0vj3Hs&feature=related>

8. Legal Research Approach: <http://www.youtube.com/watch?v=cU0lbYdyi9U&feature=related>

9. Miriam Webster Online: http://www.merriam-webster.com/

10. Online Legal Dictionary: http://dictonary.law.com

References and Bibliography

[Reproduction and Communication for Educational Purposes: The Australian *Copyright Act 1968* (the Act) allows a maximum for Fair Dealing purposes of one chapter or 10% of the pages of any book or other sourced material, whoever is the greater, to be reproduced and/or communicated by any educational institution, student or academic for the purposes of study, research, criticism or review purposes.]

*NOTE: In respect to the compilation of this online-textbook material any material used, modified or adapted in my view conforms with the 10% fair dealing and most instances less than 10% of any book or other material sourced was used and accordingly there is no perceived breach or breaches of the *Copyright Act 1968* (Cth).

Reference Books and Textbooks

1. Ardagh, A, Butterworths Questions and Answers: *Business Law:,* Australia 2001
2. Ardagh, A, Business Law Study Manual, LexisNexis Butterworths 1st edition Australia 2006
3. Barkan, S, *Law and Society: An Introduction,*1st ed Pearson Prentice Hall 2009
4. Barron ML, *Fundamentals of Business Law,* (6th edition) McGraw Hill Australia Pty Ltd 2009
5. John Bell and George Engle, *Cross: Statutory Interpretation* 3rd ed, 1995 34
6. Carvan J, *Understanding the Australian Legal System, 4th Edition, Lawbook Co a Thomson Company Australia 2002*
7. Chew, C YC, *Business Law Guidebook* Oxford University Press, Victoria 2008
8. Ciro T and Goldwasser, *Law and Business* (2nd edition) Oxford University Press 2004
9. Cook, Creyke, Geddes and Hamer, *Laying Down the Law* 7th edition LexisNexis Butterworths
10. Cook I, Walsh M and Harwood J, *Government and Government in Australia* 2nd edition, Oxford University Press Australia and New Zealand.
11. Ellis E, *Principles and Practices* of Australian Law 2nd edition, Thomson Reuters Lawbook Co 2009
12. Gamble, R, De Plessis, J and Neil, L, *Principles of Business Law* Lawbook Co. 2008
13. Gibson A and Douglas F, *Business Law* 4th edition 2009 Pearson Education Australia
14. Goldwasser V, *Mastering Business Law* LexisNexis Butterworth's Australia 2007
15. Graw, S, *An Introduction to the Law of Contract,* 5th edition, New South Wales Lawbook Co.2005
16. Harvey, C *Cornerstones of Australian Law,* (2nd edition) Tilde University Press Australia 2007
17. Heilbrom, Latimer, Nielsen and Pagone, *Introducing the Law*
18. Hinchy R, *The Australian Legal System,* (1st edition) Pearson Education Australia 2008
19. Latimer, P *Australian Business Law,* (28th edition) CCH a Wolters Kluwer Business Australia 28th edition 2009
20. LexisNexis Butterworths, *Commonwealth Legislation Collection,* Australia 2004
21. Miles C and Dowler W, *A Guide to Business Law* 18th edition Thomson Lawbook Co 2008
22. Pentony B and Lennard, J, *Butterworth's Student Companions: Business Law,* Butterworths 2000
23. Pentony B, Graw S, Lennard J and Parker D, *Understanding Business Law* 3rd edition LexisNexis Butterworths Australia 2003

24. Ryan H, Gibson, A, Rigby, S and Tamsitt, G, *Commercial Law in Principle* 1st edition, Sydney 2001
25. Sanson M, Worswick D and Anthony Thalia, *Connecting with Law* Oxford University Press Australia 2009
26. Sweeney B and O'Reilly J, *Law in Commerce,* LexisNexis Butterworth's Australia 2004
27. Terry A and Giugni D, *Business and the Law, (*5th edition) Cengage Learning Australia Pty Ltd 2009
28. Vermeesch TB and Lindgren KE, *Business Law of Australia* 15th edition
29. Vickery R and Pendleton, W, *Australian Business Law* (6th edition) Pearson Education Australia 2009

Legal Dictionaries

30. *Butterworths Concise Legal Dictionary,* 3rd edition, LexisNexis Butterworths Australia 2004
31. *Macquarie* Australia's National Dictionary, Budget Dictionary 2003