Contracts Law 101

Contracts Law Overview

Comparison of contract and tort law

The law of obligations has traditionally been divided into contractual obligations, which are voluntarily undertaken and owed to a specific person or persons, and obligations in tort which are based on the wrongful infliction of harm to certain protected interests, primarily imposed by the law, and typically owed to a wider class of persons. Recently it has been accepted that there is a third category, restitutionary obligations, based on the unjust enrichment of the defendant at the plaintiff's expense. Contractual liability, reflecting the constitutive function of contract, is generally for failing to make things better (by not rendering the expected performance), liability in tort is generally for action (as opposed to omission) making things worse, and liability in restitution is for unjustly taking or retaining the benefit of the plaintiff's money or work [Beatson (1998) Anson's Law of Contract, 27th ed. (Oxford: OUP), pg. 21].

Scope of common law contract law

Basic common law contract law addresses four sets of issues:

1. When and how is a contract formed?
2. When may a party escape obligations of a contract (such as a contract formed under duress or because of a misrepresentation)?
3. What is the meaning and effect to be given to the terms of a contract?
4. What is the remedy to be given for breach of a contract?

Contract formation: There must be an agreement which consists of an offer and acceptance, consideration (see also consideration under English law) and contractual intention for a simple contract to exist: i.e. it is not a deed - otherwise no consideration is needed.

Subject to the sine quo non of Contract Formation, other ingredients that make up a contract include:

* Form - In some cases, certain formalities (that is, writing) must be observed.
* Capacity - The parties must be legally capable of entering into a contract.
* Consent - The agreement must have been entered into freely. Consent may be vitiated by duress or undue influence.
* Legality - The purpose of the agreement must not be illegal or contrary to public policy.

A contract which possesses all of the above ingredients is said to be valid. The absence of an essential element will render the contract either void, voidable or unenforceable

In some situations, a collateral contract may exist.

Meaning and effect of contract terms: Many contract disputes involve a disagreement between the parties about what terms in the contract require each party to do or refrain from doing. Hence, many rules of contract law pertain to interpretation of terms of a contract that are vague or ambiguous. The parol evidence rule limits what things can be taken into account when trying to interpret a contract.

Privity: In general, only parties to a contract may sue for the breach of a contract.

Validity of contracts

For a contract to be valid, it must meet the following criteria:

* **Mutual agreement** - (see main article offer and acceptance): There must be an express or implied agreement. The essential requirement is that there be evidence that the parties had each from an objective perspective engaged in conduct manifesting their assent, and a contract will be formed when the parties have met such a requirement. For a contract based

on offer and acceptance to be enforced, the terms must be capable of determination in a way that it is clear that the parties assent was given to the same terms. The terms, like the manifestation of assent itself, are determined objectively.

* **Consideration**: There must be consideration (see also consideration under English law) given by all the parties, meaning that every party is conferring a benefit on the other party or himself sustaining a recognizable detriment, such as a reduction of the party's alternative courses of action where the party would otherwise be free to act with respect to the subject matter without any limitation.

* **Competent, Adult (Sui Juris) Parties**: Both parties must have the capacity to understand the terms of the contract they are entering into, and the consequences of the promises they make. For example, animals, minor children, and mentally disabled individuals do not have the capacity to form a contract, and any contracts with them will be considered void or voidable. Although corporations are technically legal fictions, they are considered persons under the law, and thus fit to engage in contracts.

For adults, most jurisdictions have statutes declaring that the capacity of parties to a contract is presumed, so that one resisting enforcement of a contract on grounds that a party lacked the capacity to be bound bears the burden of persuasion on the issue of capacity.

* **Proper Subject Matter**: The contract must have a lawful purpose. A contract to commit murder in exchange for money will not be enforced by the courts. It is void ab initio, meaning "from the beginning."

* **Mutual Right to Remedy**: Both parties must have an equal right to remedy upon breach of the terms by the other party

* **Mutual Obligation to Perform**: Both Parties must have some obligation to fulfill to the other. This can be distinct from consideration, which may be an initial inducement into the contract.

Written contracts

Contrary to common wisdom, an informal exchange of promises can still be binding and legally as valid as a written contract. A spoken contract is often called an "oral contract", not a "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 is in contrast to a "non-verbal, non-oral contract," also known as "a contract implied by the acts of the parties."

Courts in the United States have generally ruled that if the parties have a meeting of the minds, and act as though there was a formal, written and signed contract, then a contract exists. However, most jurisdictions require a signed writing for certain kinds of contracts (like real estate transactions).

In the United States, a law setting out such requirements is typically called the Statute of Frauds; the name originates from an English statute that was for "the prevention of frauds." The point of the Statute of Frauds is to prevent false allegations of the existence of contracts that were never made, by requiring formal (i.e. written) evidence of the contract. Contracts that do not meet the requirements of Statute of Frauds legislation are unenforceable, but not void. However, a party unjustly enriched by an unenforceable contract may be subject to restitution for unjust enrichment.

In Australia, for contracts subject to legislation equivalent to the Statute of Frauds, there is no requirement for the entire contract to be in writing, although 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 in some way, 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.

In England and Wales, the Statute of Frauds is still in force, but only for guarantees, which must be evidenced in writing, although the agreement may be made orally. Certain other kinds of contract (such as for the sale of land) must be in writing or they are void.

Furthermore, the existence of a written contract does not necessarily ensure its enforceability or validity. A contract can be deemed unenforceable if it requires a party to undertake an illegal act, if it was signed under duress or while intoxicated, if the disparity in knowledge between the parties is extreme and the weaker party was given onerous terms, etc. For example, in Massachusetts a contract is not enforceable if it is executed on a Sunday.

If the terms of a contract subject to Statute of Frauds legislation are to be varied, the variations must be noted in writing as well. However, the contract may be discharged orally.

If a contract is in a written form, then generally, you are bound by its terms regardless of whether you have read it or not (L'Estrange v. F Graucob Ltd [1934] 2 KB 394). However, this is tempered by the exception that if the terms of the contract are misrepresented, then the plaintiff is unable to rely on the terms of the contract; in addition, the document must be contractual in nature (Curtis v. Chemical Cleaning and Dyeing Co [1951] 1 KB 805).

Furthermore, 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 (see Balmain New Ferry Company Ltd v. Robertson (1906) 4 CLR 379). This includes such things as tickets issued at parking stations.

Void, voidable and unenforceable contracts

In general, there are three classifications of contracts that are not binding:

* **Void**: If a contract is held to be void, the contract has never come into existence. For example, a contract is void if it is based on an illegal purpose or contrary to public policy; the classic example is a contract with a hit man. Such a contract will not be recognized by a court, and cannot be enforced by either party.
* **Voidable**: A contract is voidable if one of the parties has the option to terminate the contract. Contracts with minors are examples of voidable contracts.
* **Unenforceable**: If a contract is unenforceable, neither party may enforce the other's obligations. For example, in the United States, a contract is unenforceable if it violates the Statute of frauds. An example of the above is an oral contract for the sale of a motorcycle for US$5,000 (because in the USA any contract for the sale of goods over US$500 must be in writing to be enforceable).

Uncertainty and incompleteness

If the terms of the contract are uncertain or incomplete, the parties cannot have reached an agreement in the eyes of the law. An agreement to agree does not constitute a contract, and an inability to agree on key issues, which may include such things as price, may cause the entire contract to fail.

However, a court will attempt to give effect to commercial contracts where possible, by construing a reasonable construction of the contract (see Hillas v. Arcos Ltd (1932) 147 LT 503).

Courts may also look to external standards, which are either mentioned explicitly in the contract (Whitlock v. Brew (1968) 118 CLR 445) or implied by common practice in a certain field (Three Rivers Trading Co., Ltd. v. Gwinear & District Farmers, Ltd. (1967), 111 Sol. J. 831). In addition, the court may also imply a term; if price is excluded, the court may imply a reasonable price, with the exception of land, and second-hand goods, which are unique.

Severence of unenforceable clauses

If there are uncertain or incomplete clauses in the contract, and all options in resolving its true meaning have failed, it may be possible to sever and void just those affected clauses. The test of whether a clause is severable is an objective test - whether a reasonable person would see the contract standing even without the clauses.

Spy contracts

In the U.S., one unusual type of unenforceable contract is a personal employment contract to work as a spy or secret agent. This is because the very secrecy of the contract is a condition of the contract (in order to maintain plausible deniability). If the spy subsequently sues the government on the contract over issues like salary or benefits, then the spy has breached the contract by revealing its existence. It is thus unenforceable on that ground, as well as the public policy of maintaining national security (since a disgruntled agent might try to reveal all the government's secrets during his lawsuit).

Bilateral v. unilateral contracts

Contracts may be bilateral or unilateral. The more common of the two, a bilateral contract, is an agreement in which each of the parties to the contract makes a promise or promises to the other party. For example, in a contract for the sale of a home, the buyer promises to pay the seller £200,000 in exchange for the seller's promise to deliver title to the property.

In a unilateral contract, only one party to the contract makes a promise. A typical example is the reward contract: A promises to pay a reward to B if B finds A's dog. B is not obliged to find A's dog, but A is obliged to pay the reward to B if B finds the dog. In this example, the finding of the dog is a condition precedent to A's obligation to pay.

An offer of a unilateral contract may often be made to many people (or 'to the world') by means of an advertisement. In that situation, acceptance will only occur on satisfaction of the condition (such as the finding of the offeror's dog). If the condition is something that only one party can perform, both the offeror and offeree are protected — the offeror is protected because he will only ever be contractually obliged to one of the many offerees; and the offeree is protected, because if she does perform the condition, the offeror will be contractually obliged to pay her.

In unilateral contracts, the requirement that acceptance be communicated to the offeror is waived. The offeree accepts by performing the condition, and the offeree's performance is also treated as the price, or consideration, for the offeror's promise.

The most common type of unilateral contract is the insurance contract. The insurance company promises to pay the insured a stated amount of money on the happening of an event if the insured pays premiums; note that the insured does not make any promise to pay the premiums.

Courts generally favor bilateral contracts. The general rule in the United States is: "In case of doubt, an offer is interpreted as inviting the offeree to accept either by promising to perform what the offer requests or by rendering the performance, as the offeree chooses." Restatement (Second) of Contracts § 32 (1981) (emphasis added). Here the law attempts to provide some protection from the risk of revocation in a unilateral contract to the offeree. Note that if the offer specifically requests performance rather than a promise, a unilateral contract will exist. See option contracts for more information on protection given to the offeree in a unilateral contract.

Express and implied contracts

A contract can be either an express contract or an implied contract. An express contract is one in which the terms are expressed verbally, either orally or in writing. An implied contract is one in which some of the terms are not expressed in words.

Implied in fact or implied in law

An implied contract can either be implied in fact or implied in law. A contract which is implied in fact is one in which the circumstances imply that parties have reached an agreement even though they have not done so expressly. For example, by going to a doctor for a physical, a patient agrees that he will pay a fair price for the service. If he refuses to pay after being examined, he has breached a contract implied in fact.

Quasi-contract

A contract which is implied in law is also called a quasi-contract, because it is not in fact a contract; rather, it is a means for the courts to remedy situations in which one party would be unjustly enriched were he or she not required to compensate the other. For example, an unconscious patient treated by a doctor at the scene of an accident has not agreed (either expressly or by implication) to pay the doctor for emergency services, but the patient would be unjustly enriched by the doctor's services were the patient not required to compensate the doctor.

Incorporation of terms

Course of dealing

If two parties have regularly conducted business on certain terms, it may be reasonable to presume that in future dealings where there is no contract, the parties wish to incorporate the terms of the previous contracts. However, if a party wishes to incorporate terms by course of dealing, the original document must have been contractual in nature, and delivery receipts may not fit this description. In Australia, there is a further requirement that the document was procured after formation.

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Express and implied terms

Different types of statements

Whether a statement is a term of a contract is important because only if a promise is a term of the contract can a party sue for the breach of the contract. Statements can be split into the following types:

* **Puff (sales talk)**: If no reasonable person hearing this statement would take it seriously, it is a puff, and no action in contract is available if the statement proves to be wrong.
* **Representation**: A representation is a statement of fact made to induce another person to enter into a contract and which does induce them to enter into a contract, but it is one that the maker of the statement does not guarantee its truth. If the statement proves to be incorrect, it cannot be enforced, as it is not a term of the contract, but it may prove to be a misrepresentation, whereupon other remedies are available.
* **Term**: A term is similar to a representation, but the truth of the statement is guaranteed by the person who made the statement. The test is an objective test.

Factors that a court may take into account in determining the nature of a statement include:

* **Timing**: If the contract was concluded soon after the statement was made, this is a strong indication that the statement induced the person to enter into the contract.
* **Content of statement**: It is necessary to consider what was said in the given context, which has nothing to do with the importance of a statement.
* **Knowledge and expertise**: In Oscar Chess Ltd v. Williams [1957] 1 WLR 370, a person selling a car to a second-hand car dealer stated that it was a 1948 Morris, when in fact it was a 1939 model car. It was held that the statement did not become a term because a reasonable person in the position of the car dealer would not have thought that an inexperienced person would have guaranteed the truth of the statement.

Terms implied in fact

The Privy Council proposed a five stage test in BP Refinery Western Port v. Shire of Hastings:

1. **Reasonableness and equitableness**: The implied term must be reasonable and equitable.
2. **Business efficacy**: The implied term must be necessary for the business efficacy of the contract. For instance, if the term simply causes the contract to operate better, that does not fit this criterion.
3. **Obviousness**: The term is so obvious that it goes without saying. Furthermore, there must be one and only one thing that would be implied by the parties. For example, in Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales (1982) 149 CLR 337, a term regarding the inability of construction company to work three shifts a day could not be implied because it was unclear what form it would have taken.
4. **Clear expression**: The term must be capable of clear expression. No specific technical knowledge should be required.
5. **Consistency**: The implied term may not contradict an express term.

In Australia, the High Court has ruled that the test in BP Refinery applies only to formal contracts, while the test in Byrne and Frew v. Australian Airlines Ltd (1995) 185 CLR 410 shall apply to informal contracts:

* **Necessity**: The term must be necessary to ensure reasonable or effective operation of a contract of the nature before the court.
* **Consistency**: The implied term may not contradict an express term (same as for formal contracts).
* **Clear expression**: The term must be capable of clear expression (same as for formal contracts).
* **Obvious**: McHugh and Gummow JJ have stated that it must also be obvious.

Terms implied in law

These are terms that have been implied into standardised relationships. The other difference between this and terms implied in fact is that the test is one of necessity (Liverpool City Council v. Irwin [1976] 2 WLR 562); a necessary term is one where the contract is rendered worthless or nugatory if it is without it.

Terms implied by custom or trade

You are generally bound by the custom of the industry that you are in. To imply a term due to custom or trade, you must prove the existence of the custom, which must be notorious, certain, legal and reasonable (Con-stan Industries of Australia Pty Ltd v. Norwich Winterthur Insurance (Australia) Ltd (1986) 160 CLR 226). See also Frigaliment Importing Co., Ltd., v. B.N.S. International Sales Corp., 190 F. Supp. 116 (S.D.N.Y. 1960) (plaintiff failed to prove what he meant by "chicken") and U.C.C. § 1-205.
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Agreements to negotiate

It is common for lengthy negotiations to be written into a heads of agreement document that includes a clause to the effect that the rest of the agreement is to be negotiated. Although these cases may appear to fall into the category of agreement to agree, courts nowadays (at least in Australia) will imply an obligation to negotiate in good faith provided that certain conditions are satisfied (Coal Cliff Collieries Pty Ltd v. Sijehama Pty Ltd (1991) 24 NSWLR 1):

* Negotiations were well-advanced and the large proportion of terms have been worked out; and
* There exists some mechanism to resolve disputes if the negotiations broke down.

The test of whether one has acted in good faith is a subjective one; the cases suggest honesty, and possibly also reasonably.

"Subject to" contracts

If a contract specifies "subject to contract", it may fall into one of three categories (Masters v. Cameron (1954) 91 CLR 353):

1. The parties are immediately bound to the bargain, but they intend to restate the deal in a formalised contract that will not have a different effect; or

2. The parties have completely agreed to the terms, but have made the execution of some terms in the contract conditional on the creation of a formalised contract; or
3. It is merely an agreement to agree, and the deal will not be concluded until the formalised contract has been drawn up.

If a contract specifies "subject to finance", it imposes obligations on the purchaser (Meehan v. Jones (1982) 149 CLR 571):

* The purchaser must seek finance; and
* When offers of finance arrive, the purchaser must make a decision as to whether the offers of finance are suitable.

Once again, there is an element of good faith involved.

This may also refer to contingent conditions, which come under two categories: condition precedent and condition subsequent. Conditions precedent are conditions that have to be complied with before performance of a contract. With conditions subsequent, parties have to perform until the condition is not met. Failure of a condition does not void the contract, it is just regarded as voidable.

Statutory law applicable to contracts

The rules by which many contracts are governed are provided in specialized statutes that deal with particular subjects. Most countries, for example, have statutes which deal directly with sale of goods, lease transactions and trade practices. For example, most American states have adopted Article 2 of the Uniform Commercial Code, which regulates contracts for the sale of goods.

There are also many acts around the world which deal with specific types of transactions and businesses. For example, the states of California and New York in the U.S. have statutes that govern the provision of services to customers by health studios, and the UK has the Sale of Goods Act 1979 which governs the contracts between sellers and buyers.

Remedies

Damages

Typically, the remedy for breach of contract is an award of money damages. Courts usually adopt one of three ways of calculating the value of damages.

The most common is to assess the sum which would restore the injured party to the economic position that he or she expected from performance of the promise or promises (known as an "expectation measure" or "benefit-of-the-bargain" measure of damages).

When it is either not possible or desirable to award damages measured in that way, a court may award money damages designed to restore the injured party to the economic position that he or she had occupied at the time the contract was entered (known as the "reliance measure"), or designed to prevent the breaching party from being unjustly enriched ("restitution").

Specific perfomance

There may be circumstances in which it would be unjust to permit the defaulting party simply to buy out the injured party with damages. For example where an art collector purchases a rare painting and the vendor refuses to deliver, the collector's damages would be equal to the sum paid.

The court may make an order of what is called "specific performance", requiring that the contract be performed. In some circumstances a court will order a party to perform his or her promise (an order of "specific performance") or issue an order, known as an "injunction," that a party refrain from doing something that would breach the contract.

Both an order for specific performance and an injunction are discretionary remedies, originating for the most part in equity. Neither is available as of right and in most jurisdictions and most circumstances a court will not normally order specific performance.

Procedure

In the United States, in order to obtain damages for breach of contract or to obtain specific performance, the injured party may file a civil (non-criminal) lawsuit, usually in a state court, or petition a private arbitrator to decide the contract issues presented.

Many contracts provide that all contract disputes must be arbitrated by the parties to the contract, rather than litigated in courts. By law, some contracts, including most securities brokerage contracts, must be arbitrated; other contracts are referred by courts as a matter of local law or policy. Arbitrated judgements are generally enforced and appealed in the same manner as ordinary court judgements; a majority of states have adopted the Uniform Arbitration Act to facilitate the enforcement of arbitrated judgements.

In England and Wales, a contract may be enforced by use of a claim, or in urgent cases by applying for an interim injunction to prevent a breach.

Theoretical considerations

Contract theory is the body of legal theory that addresses normative and conceptual questions in contract law. One of the most important questions asked in contract theory is why contracts are enforced. One prominent answer to this question focuses on the economic benefits of enforcing bargains. Another approach, associated with Charles Fried, maintains that the purpose of contract law is to enforce promises. This theory is developed in Fried's book, Contract as Promise. Other approaches to contract theory are found in the writings of legal realists and critical legal studies theorists.

Contract Formation

Offer and Acceptance

Offer and acceptance analysis is a traditional approach in contract law used to determine whether an agreement exists between two parties. An offer is an indication by one person to another of their willingness to contract on certain terms without further negotiations. A contract is then formed if there is express or implied agreement. A contract is said to come into existence when acceptance of an offer has been communicated to the offeror by the offeree.

The offer and acceptance formula, developed in the 19th century, identifies a moment of formation when the parties are of one mind. This classical approach to contract formation has been weakened by developments in the law of estoppel, misleading conduct, misrepresentation and unjust enrichment.

Offer

The nature of an offer

An **offer** is an expression of willingness to contract on certain terms, made with the the intention that it shall become binding as soon as it is accepted by the person to whom it is addressed, the "offeree" [G.H. Tretel, The Law of Contract, 10th edn, p.8].

The "expression" referred to in the definition may take different forms, such as a letter, newspaper, fax, email and even conduct, as long as it it communicates the basis on which the offeror is prepared to contract.

The "intention" referred to in the definition is objectively judged by the courts. The English case of Smith v. Hughes (1871) LR 6 QB 597 emphasises that the important thing is not a party's real intentions but how a reasonable person would view the situation. This is due mainly to common sense as each party would not wish to breach his side of the contract if it would make him or her culpable to damages, it would especially be contrary to the principle of certainty and clarity in commercial contract and the topic of mistake and how it affect the contract.

The classical principles are illustrated in the well-known case of Carlill v. Carbolic Smoke Ball Company.

Unilateral contract

The contract in Carlill v. Carbolic Smoke Ball Co was of a kind known as a unilateral contract, one in which the offeree accepts the offer by performing his or her side of the bargain. It can be contrasted with a bilateral contract, where there is an exchange of promises between two parties. In Australian Woollen Mills Pty Ltd v. The Commonwealth (1954), the High Court of Australia held that, for a unilateral contract to arise, the promise must be made "in return for" the doing of the act. The court distinguished between a unilateral contract from a conditional gift. The case is generally seen to demonstrate the connection between the requirements of offer and acceptance, consideration and intention to create legal relations.
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Invitations to treat

An invitation to treat is not an offer, but an indication of a person's willingness to negotiate a contract. In Harvey v Facey, an indication by the owner of property that he or she might be interested in selling at a certain price, for example, has been regarded as an invitation to treat. The courts have tended to take a consistent approach to the identification of invitiations to treat, as compared with offer and acceptance, in common transacions. The display of goods for sale, whether in a shop window or on the shelves of a self-service store, is ordinarily treated as an invitation to treat and not an offer. The holding of a public auction will also usually be regarded as an invitation to treat.
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Revocation of offer

An offeror may revoke an offer before it has been accepted, but the revocation must be communicated to the offeree, although not necessarily by the offeror. If the offer was made to the entire world, such as in Carlill's case, the revocation must take a form that is similar to the offer. However, an offer may not be revoked if it has been encapsulated in an option (see also option contract).

If the offer is a unilateral offer, unless there was an ancillary contract entered into that guaranteed that the main contract would not be withdrawn, the contract may be revoked at any time: see Mobil Oil Australia Ltd v. Wellcome International Pty Ltd (1998) 81 FCR 475.

Acceptance

Test of acceptance

Acceptance is a final and unqualified expression of assent to the terms of an offer [G.H. Treitel, The Law of Contract, 10th edn, p.16]. It is no defense to an action based on a contract for the defendant to claim that he never intended to be bound by the agreement if under all the circumstances it is shown at trial that his conduct was such that it communicated to the other party or parties that the defendant had in fact agreed. Signing of a contract is one way a party may show his assent. Alternatively, an offer consisting of a promise to pay someone if the latter performs certain acts which the latter would not otherwise do (such as paint a house) may be accepted by the requested conduct instead of a promise to do the act. The performance of the requested act indicates objectively the party's assent to the terms of the offer.

The essential requirement is that there be evidence that the parties had each from an objective perspective engaged in conduct manifesting their assent. This manifestation of assent theory of contract formation may be contrasted with older theories, in which it was sometimes argued that a contract required the parties to have a true meeting of the minds between the parties. Under the "meeting of the minds" theory of contract, a party could resist a claim of breach by proving that although it may have appeared objectively that he intended to be bound by the agreement, he had never truly intended to be bound. This is unsatisfactory, as the other parties have no means of knowing their counterparts' undisclosed intentions or understandings. They can only act upon what a party reveals objectively to be his intent. Hence, an actual meeting of the minds is not required.

This requirement of an objective perspective is important in cases where a party claims that an offer was not accepted, taking advantage of the performance of the other party. Here, we can apply the test of whether a reasonable bystander (a "fly on the wall") would have perceived that the party has impliedly accepted the offer by conduct.

Rules of acceptance

Communication of acceptance

There are several rules dealing with the communication of acceptance:

* The acceptance must be communicated: Depending on the construction of the contract, the acceptance may not have to come until the notification of the performance of the conditions in the offer as in Carlill's case, but nonetheless the acceptance must be communicated. Prior to acceptance, an offer may be withdrawn.
* An offer can only be accepted by the offeree, that is, the person to whom the offer is

made.
* An offer is not bound if another person accepts the offer on his behalf without his authorisation: see agent (law).
* It may be implied from the construction of the contract that the offeror has dispensed with the requirement of communication of acceptance.
* If the offer specifies a method of acceptance (such as by post or fax), you must accept it using a method that is no less effective than the method specified.
* Silence cannot be construed as acceptance: see Felthouse v. Bindley (1862) 142 ER 1037.

Correspondence with offer

The "mirror image rule" states that if you are to accept an offer, you must accept an offer exactly, without modifications; if you change the offer in any way, this is a counter-offer that kills the original offer. However, a mere request for information is not a counter-offer. It may be possible to draft an enquiry such that is adds to the terms of the contract while keeping the original offer alive.

Battle of the forms

Often when two companies deal with each other in the course of business, they will use standard form contracts. In Butler Machine Tool Co Ltd v. Ex-Cell-O Corporation (England) Ltd [1979] WLR 401, the question was raised as to which of the standard form contracts prevailed in the transaction. Denning MR preferred the view that the documents were to be considered as a whole, and the important factor was finding the decisive document; on the other hand, Lawton and Bridge LJJ preferred traditional offer-acceptance analysis, and considered that the last counter-offer killed all preceding offers.

Postal acceptance rule

As a rule of convenience, if the offer is accepted by post, the contract comes into existence at the moment that the acceptance was posted. This rule only applies when, impliedly or explicitly, the parties have in contemplation post as a means of acceptance. It excludes contracts involving land, letters incorrectly addressed and instantaneous modes of communication.

See main article: [Mailbox rule.]

Knowledge of the offer

In Australian law, there is a requirement that an acceptance is made in reliance or persuance of an offer: see R v. Clarke.

Rejection, death or lapse of time

If the offeree rejects the offer, the offer has been killed and cannot be accepted at a further date. The offer also cannot be accepted after the time period specified in the offer, or if no time was specified, after a reasonable period of time. If the offeror dies, the offeree may accept only if the acceptance is done without the knowledge of the death; conversely, the estate of a deceased offeree may not accept an offer.

Formation

A contract will be formed (assuming the other requirements are met) when the parties give objective manifestation of an intent to form the contract. Of course, the assent must be given to terms of the agreement. Usually this involves the making by one party of an offer to be bound upon certain terms, and the other parties' acceptance of the offer on the same terms. The acceptance of an offer may be either a statement of agreement, or, if the offer invites acceptance in this way, a performance of an act requested in the terms of the offer. For instance, if one tells a neighbor kid that if the kid mows the offeror's lawn, the offeror will pay $20.00, and the kid does mow the lawn, the act of mowing constitutes the manifestation of the kid's assent. For a contract based on offer and acceptance to be enforced, the terms must be capable of determination in a way that it is clear that the parties assent was given to the same terms. The terms, like the manifestation of assent itself, are determined objectively. They may be written, or sometimes oral, although some kinds of contracts require a writing as evidence of the agreement to be enforced. For information on the written requirements of contracts, see the main contract article.

Criticisms

Criticisms of offer-acceptance analysis lie in that this tool was created by legal academics and can be rather arbitrary at time, and bears little resemblance to how lay-people perceive the formation of a contract.

Mailbox Rule

Mailbox rule

The **mailbox rule** or the **postal acceptance rule** is a term of common law contracts which determines when a contract has been formed where the parties are communicating via the mail. The basic thrust of the rule is that an acceptance of an offer that is sent before a revocation of the offer is received. However, if a communication is sent rejecting the offer, and a later communication is sent accepting the contract, then the first one to be received by the offeror will prevail.

For example, suppose A makes an offer to B on January 1; A then decides to revoke the offer on January 2, and puts a letter in the mail to B revoking the offer; however, B puts a letter accepting the offer in the mail on January 3, and does not receive A's revokation letter until January 4. Because B sent his acceptance before receiving A's revocation, the mailbox rule dictates that B's acceptance is effective. A will therefore be bound to the contract, and can no longer revoke the offer.

Suppose, on the other hand, that A makes an offer to B on January 1, and B decides to reject the offer on January 2, and puts a letter in the mail to A rejecting the offer; however, the next day B changes his mind and sends A a fax accepting the offer. In this situation, whichever communication A receives first will govern.

Under the mailbox rule, performance is a means of acceptance. If A orders 1000 blue coathangers, and B ships them out, that shipment is considered to be a conveyance of acceptance of A's offer to buy the coathangers. Defective performance is also an acceptance, unless accompanied by an explanation. For example, if A orders 1000 blue coathangers, and B mistakenly ships 1000 red coathangers, this is still an acceptance of the contract. However, if B ships the red coathangers with a note that they sent these because they had run out of blue coathangers, this is not an acceptance, but rather an accommodation, which is a form of counter-offer.

With the advent of modern technology, the mailbox rule has been expanded to cover all technology by which commercial communication may reasonably be conducted, including by telephone, telegraph, fax and e-mail. However, if the offeree were to convey acceptance by commercially unreasonable means - by cross-country pony express, for example - the acceptance would not be effective until it had actually been received.

Please note that the mailbox rule does **not** apply to option contracts, where acceptance is still only effective upon receipt.

Mirror Image Rule

Mirror Image Rule

In the law of contracts, the **mirror image rule states** that an offer must be accepted exactly without modifications. An attempt to accept the offer on different terms instead creates a counter-offer - which constitutes a rejection of the original offer.

In the United States, this rule has been altered with respect to merchants dealing under the Uniform Commercial Code. In such situations, an acceptance that does not match the terms of the offer is nonetheless effective. The terms of the acceptance that do not materially differ from the original offer will govern the contract as a whole.

Invitation to Treat

Invitation to Treat

In contract law, an **invitation to treat** (invitation to bargain in the US) is an action by one party which may appear to be a contractual offer but which is actually inviting others to make an offer of their own. The distinction is important because if a legitimate contractual offer is accepted by another, a binding contract is immediately formed and the terms of the original offer cannot be further negotiated without both parties' consent. An invitation to treat may be seen as a request for expressions of interest.

The clearest example of an invitation to treat is a tender process. The party tendering out services is not obliged to sign a contract with the first party who submits a tender proposal. An auction may be more ambiguous. Generally an auction may be seen be an invitation to treat, with the property owner asking for offers of a certain amount and then selecting which to accept. However, if it is stated by the owner that there is no reserve price or that there is a reserve price beyond which offers will be accepted then the auction is most likely a contractual offer which is accepted by the highest bidder (Spencer v Harding (1870) LR 5 CP 561) .

A shop owner displaying their goods for sale is generally making an invitation to treat. They are not obliged to sell the good to anyone who is willing to pay for them, even if additional signage such as "special offer" accompanies the display of the good. This distinction was legally relevant in Fisher v Bell 1961 1 QB 394 where it was held that displaying a flicknife for sale in a shop did not contravene legislation which prohibited offering for sale such a weapon. The distinction also means that if a shop mistakenly displays a good for sale at a very low price it is not obliged to sell it for that amount.

Consideration

Consideration

Consideration is a central concept in the common law of contracts. Under classical contract theory, consideration is required for a contract to be enforceable. (Modern contract theory has also permitted remedies on alternate theories such as promissory estoppel).

There are two common theories for consideration. The first is the "benefit-detriment theory", in which a contract must be either to the benefit of the promisor or to the detriment of the promisee to constitute consideration. The second is the "bargain theory", in which the parties subjectively view the contract to be the product of an exchange or bargain. The bargain theory has largely replaced the benefit-detriment theory in modern contract theory, instance, a deal i which the promisee feels subjectively relieved, but hasn't actually gained any legal rights, might satisfy the bargain theory but not the benefit-detriment theory. Alternately, a deal in which an actor takes detrimental actions possibly in reaction to an offer, without having viewed the deal as a bargain, wouldn't be viewed as a contract under the law.

The main purpose of the shift from benefit-detriment to bargain theory is to reconcile consideration theory with other aspects of contract theory. For instance, courts will not inquire as to the adequacy of consideration. If someone honestly dislikes their car and wants to sell it for fifty dollars, the law will not consider this an invalid deal. However, the court will reject "consideration" that was not truly bargained for. Occasionally the court may refer to "adequate" or "valuable" consideration, but in reality the court is not examining the adequacy of consideration, but whether or not it was bargained for. Another term for this sort of non-bargained-for payment is nominal consideration. The traditional notion that courts won't look into the adequacy of consideration, an ancient notion in the English common law, doesn't square with the benefit-detriment theory (in which courts are implicitly analyzing if the parties are receiving a sufficient benefit) but does square with the bargain theory (in which only the subjective intentions of the parties are considered).

For example, in Fischer v. Union Trust Co., 101 N.W. 852, the court held that $1.00 paid in exchange for the sale of real property within the city of Detroit in 1902 was not "bargained for" by the seller, and thus the transaction was void. The point was NOT that the amount of money involved was too small to be adequate consideration, but that the seller did not convey the property in exchange for the buyer's promise to pay $1.00. There was no consideration, not because $1.00 was too small an amount to "count", but because the $1.00 offered the seller by the buyer did not induce the seller to part with the property.

There are three main purposes cited for the consideration requirement. The first is the cautionary requirement - parties are more likely to look before they leap when making a bargain than when making an off-the-cuff promise of a gift. The second is the evidentiary requirement - parties are more likely to commemorate, or at least remember, a promise made due to a bargaining process. The third is the channeling requirement - parties are more likely to coherently stipulate their specific desires when they are forced to bargain for them. Each of these rationales ensure that contracts are made by serious parties and are not made in error.

Certain other stipulations regarding consideration include the following:

* Past consideration is not valid. Something that is already done is done, and it does not change the legal position of the promisor. Any goods or services to be exchanged must be

exchanged at or after the time of contract formation. However, a promise to pay a pre-existing debt or obligation IS enforceable.

* Preexisting duty does not count as consideration.

* An illusory promise, or one which the promisor actually has no obligation to keep, does not count as consideration. The promise must be real and unconditional. This doctrine rarely invalidates contracts; it is a fundamental doctrine in contract law that courts should try to enforce contracts whenever possible. Accordingly, courts will often read implied-in-fact or implied-in-law terms into the contract, placing duties on the promisor. For instance, if a promisor promises to give away a third of his earnings for the year, he has no actual obligation to do anything; if he earns nothing, a third of zero is zero. However, courts will generally read in an implied term that he will use reasonable efforts to try to gain income. Another, more modern approach to illusory promises is to treat them as "bargaining for a chance". Even though the promisor has no actual duties, the promisee may still benefit by the possibility that the contract may lead to the promisor fulfilling certain duties, and that possibility itself is beneficial.

* Liquidated debt, or a payment which is fixed and undisputed, cannot be negotiated for consideration. Unliquidated debt, or a payment which is disputed, can be used for consideration.

While the concept of consideration is not generally accepted in civil law systems, some recognize the similarity between consideration and cause, as some civil codes recognize that all contracts must have a cause, though this is not generally accepted.

Defenses Against Formation

Lack of Capacity to Contract

Capacity

Capacity and **incapacity** are legal terms that refer to the ability of persons to make certain binding dispositions of their rights, such as entering into contracts, making gifts, or writing a valid will. When a person is barred from engaging in such activities, attempts to do so are void for incapacity.

Incapacity has been held by many courts not to be a defense to torts, however, because immunizing the incapacitated from liability for their wrongs would prevent injured parties from recovering from their losses.

Some categories of people have had their freedom to enter into contracts restricted. These categories obviously vary depending on legal jurisdiction. For example, under British Columbia law the categories are:

* **Infants**. (The definition of an infant differs in various jurisdictions, depending on what the age of majority is in that jurisdiction.) An infant is not bound by the contracts he or she enters into except for the purchase of necessaries and for beneficial contracts of service. Infants must pay fair price only for necessary goods and services. In contracts between an adult and an infant, adults are bound but infants may escape contracts at their option (i.e. the contract is voidable). Infants may ratify a contract on reaching age of majority. In the

case of executed contracts, when the infant has obtained some benefit under the contract, he/she cannot avoid obligations unless what was obtained was of no value. It should be noted that the British Columbia Infants Act (RSBC 1996 c.223) declares all contracts with infants to be unenforceable, including those for necessities. Upon repudiation of a contract, either party can apply to the court. The court may order restitution, damages, or discharge the contract. All contracts involving the transfer of real estate are considered valid until ruled otherwise.

The **age of legal capacity** is a legislatively or court ordained time when a legal person or legal entity acquires the ability to exercise rights. This age often varies by jurisdiction and the particular rights involved. The right to vote in the United States is currently set at 18 years, while the right to buy and consume alcohol is often set at 21 years by state law. Some laws, such as marriage laws, may differentiate between sexes and allow women to marry younger. There are instances in which a person may be able to gain capacity earlier than the prescribed time through a process of emancipation.

* **Insane**. Persons claiming insanity must show that they did not understand what they were doing and that the other person knew or ought to have known of the insanity.
* **Intoxicated**. Contracts entered into while intoxicated are treated like insanity. They must be repudiated as soon as sober.
* **Enemy Aliens** may have contracts void or suspended in event of outbreak of war.
* **Bankrupts**: before discharge they must notify creditors, but after discharge they are returned to full capacity. In the United States, some states have spendthrift laws under which an irresponsible spender may be deemed to lack capacity to enter into contracts.
* **Corporations**. The capacity of corporations depends on the method of incorporation. The capacity of crown corporations are limited by legislation.
* **Unions** have limited capacity unless the contract relates to union activities.

Under the old common law of England, married women were considered to be incapacitated, but this is no longer the case.

When a person or entity lacks capacity for any reason, including age, a court may declare that person or entity a ward of the state and grant power of attorney to an appointed legal guardian, administrator, receiver, executor or other similar legal functionary.

[Duress]

Duress

Duress in the context of contract law is a common law defence, and if you are successful in proving that the contract is vitiated by duress, you can rescind the contract, since it is then voidable.

Duress in contract law (in Australia at least) falls into two broad categories:

* Physical duress, and
* Economic duress

Physical duress

Duress to the person

In Barton v. Armstrong [1976] AC 104, a decision of the Privy Council, Armstrong threatened to kill Barton if he did not sign a contract, which was set aside due to duress to the person. An innocent party wishing to set aside a contract for duress to the person need only to prove that the threat was made and that it was a reason for entry into the contract; the onus of proof then shifts to the other party to prove that the threat had no effect in causing the party to enter into the contract.

Duress to goods

In such cases, one party refuses to release the goods belonging to the other party until the other party enters into a contract with them. For example, in Hawker Pacific Pty Ltd v Helicopter Charter Pty Ltd (1991) 22 NSWLR 298, the contract was set aside after Hawker Pacific's threats to withhold the helicopter from the plaintiff unless further payments were made for repairing a botched paint job.
[edit]

Economic duress

Although hard bargaining occurs legitimately in commercial situations, there is a point where it becomes economic duress. Putting aside issues of consideration, this often involves one party threatening to breach an existing contract between the two parties unless the innocent party agrees to enter into another contract. The contract is voidable if the innocent party can prove that it had no other practical choice (as opposed to legal choice) but to agree to the contract.

Undue Influence

Undue influence (as a term in jurisprudence) is an equitable doctrine that involves one person taking advantage of a position of power over another person.

Undue influence in contract law

If undue influence is proved in a contract (at least in Australia), the contract is voidable by the innocent party, and the remedy is rescission. There are two categories to consider:

* Presumed undue influence
* Actual undue influence

Presumed undue influence

First subgroup

In the first subgroup, the relationship falls in a class of relationships that as a matter of law will raise a presumption of undue influence. Such classes include:

* Parent/child
* Guardian/ward
* Priest/member of parish
* Solicitor/client
* Doctor/patient

In such cases, the onus of proof lies on a doctor, say, to disprove undue influence on a patient.

Second subgroup

The second subgroup covers relationships that do not fall into the first subgroup, but on the facts of case, there was an antecedent relationship between the parties that led to undue influence. The test is one of whether there was a relationship of such trust and confidence that it should give rise to such a presumption (see Johnson v. Buttress (1936) 56 CLR 113).

Actual undue influence

An innocent party may also seek to have a contract set aside for actual undue influence, where there is no presumption of undue influence, but there is evidence that the power was unbalanced at the time of the signing of the contract.

Illusionary Promise

In contract law, an **illusory promise** is one that courts will not enforce. This is in contrast with a contract, which is a promise that courts will enforce. A promise may be illusory for a number of reasons. In common law countries this usually results from failure or lack of consideration (see also consideration under English law).

Illusory promises are so named because they merely hold the illusion of contract. For example, a promise of the form, "I will give you ten dollars if I feel like it." is purely illusory and will not be enforced as a contract.

It is a general principle of contract law that courts should err on the side of enforcing contracts. Parties entering into the arrangement presumably had the intention of forming an enforceable contract, and so the court should attempt to follow this intention. Methods of doing so include:

Implied-in-law "good faith" terms

Many contracts include "satisfaction clauses", in which a promisor can refuse to pay if he isn't subjectively satisfied with the promisee's performance. Strictly speaking, this is an illusory promise, since the promisor has no actual legal burden to pay if he chooses not to. However, courts will generally imply in law that the promisor must act in good faith, and only reject the deal if he is genuinely dissatisfied. As another example, if a contract promises a promisee a certain percentage of the proceeds of a promisor's business activities, this is illusory, since the promisor doesn't have to do anything - zero percent of zero is zero. However, courts will imply that the promisor promised a good-faith effort to try to make money, and cite him for breach of contract if he does absolutely nothing.

Implied-in-fact terms

Judges will often infer terms into the contract that the parties did not explicitly cite. For instance, in the "satisfaction clause" case, judges might infer that the parties intended a "reasonableness test" - that the clause could be satisfied if a reasonable person would be satisfied by the promisee's performance, regardless of whether the promisor himself asserts he is satisfied. (This interpretation is often used in cases in which a performance can be objectively evaluated, such as with the construction of a warehouse; the implied-in-law interpretation above is preferred where satisfaction is more subjective, as with the painting of a portrait.)

Bargaining for a chance

Many judges would consider the "bargaining for a percentage of the proceeds" example above an enforceable contract, even without an implied-in-fact or implied-in-law good faith term. They would view the opportunity to enter into a business relationship to itself be acceptable consideration. Put differently, the mere possibility that the promisor would do business is a valuable product of the bargain, even if he doesn't do anything. Of course, if the promisor entered into the relationship purely with the intent of fraudulently harming the promisee, he could be cited for fraud or bad faith principles which apply to all contracts.

Statute of Frauds

The **statute of frauds** refers to a requirement in many common law jurisdictions that certain kinds of transactions, typically contractual obligations, be evidenced by a writing signed by the party against whom enforcement is sought, or by the party's authorized agent. The term comes from an English statutory law (29 Car. II c. 3) passed in 1677. It is more properly called the **Statute of Frauds and Perjuries**.

The writing that the Statute requires is a precondition to maintaining a suit for breach of contract (or other obligation). However, the Statute is used as a defense, which defense is waived if the person against whom enforcement is sought fails to raise in a timely manner. Thus, the burden of showing evidence that such a writing exists only comes into play when a Statute of Frauds defense is raised by the defendant. A defendant who admits the existence of the contract in his pleadings, under oath in a deposition or affidavit, or at trial, may not use the defense.

Traditionally, the statute of frauds requires a writing signed by the party against whom enforcement is sought in the following circumstances:

* Contracts in consideration of marriage
* Contracts which cannot be performed within one year
* Contracts for the sale of land
* Contracts by the executor of a will to pay a debt of the estate with his own money
* Under the Uniform Commercial Code, contracts for the sale of goods where the price exceeds $500.00
* Contracts in which one party becomes a surety (acts as guarantor) for another party's debt or other obligation.

Law students often remember these circumstances by the mnemonic "MYLEGS" (marriage, year, land, executor, goods, surety).

Uniform Commercial Code section 1-206 also sets out a "catch-all" statute of frauds for personal property not covered by any other specific law, stating that a contract for the sale of such property where the purchase price exceeds $5,000.00 is not enforceable unless memorialized by a signed writing. This section, however, is rarely invoked in litigation.

Interestingly, with respect to securities transactions, the Uniform Commercial Code (section 8-113) has abrogated the statute of frauds. The drafters of the most recent revision commented that "with the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business."

The Statute of Frauds also applies to modified contracts - for example, suppose party A makes an oral agreement to lease a house from party B for 9 months. Immediately after taking possession party A decides that he really likes the place, and makes an oral offer to party B to extend the term of the lease by 6 months. Although neither agreement alone comes under the Statute of Frauds, the extension modifies the original contract to make it a 15-month lease, thereby bringing it under the Statute. In practice, this works in reverse as well - an agreement to reduce the lease from 15 months to 9 months would not require a writing. However, almost all jurisdictions have enacted statutes that require a writing in such situations.

Non est factum

Non est factum – latin for "it is not my deed" – is a doctrine in contract law that allows a signing party to escape performance of the agreement. A claim of non est factum means that the signature on the contract was signed by mistake, without knowledge of its meaning, but was not done so negligently. A successful plea would void the contract.

Contract Interpretation

Parol Evidence Rule

The **parol evidence rule** enacts a principle of the common law of contracts that presumes that a written contract embodies the complete agreement between the parties thereto. The rule therefore generally forbids the introduction of evidence before a judge or jury of extrinsic evidence - evidence of communications between the parties not contained in the language of the contract itself - claimed to change the terms of a later written contract.

In order for the rule to be effective, the contract in question must be a complete, or integrated writing; it must, in the judgment of the court, contain all terms that the parties would logically expect to have within such an agreement. One way to ensure that the contract will be found to be a complete agreement for this purpose is through the inclusion of a merger clause, which recites that the contract of which it is part is, in fact, the complete agreement of the parties.

The parol evidence rule only applies to determining the meaning of a term of a contract; it does not apply when determining whether a right constitutes a term of the contract. Also, despite this rule, the court will examine the factual matrix surrounding the contract.

There are a number of exceptions to the parol evidence rule. Extrinsic evidence can always be admitted for the following purposes:

* To work out the subject matter of the contract.
* To resolve an ambiguity in the contract.
* To show that an unambiguous term in the contract is in fact a mistaken transcription of a prior valid agreement. Such a claim must be established by clear and convincing evidence, and not merely by the preponderance of the evidence.
* To show fraud, duress, mistake, or illegal purpose on the part of one or both parties.
* To show that consideration has not actually been paid. For example, if the contract states that A has paid B $1,000 in exchange for a painting, B can introduce evidence that A had never actually conveyed the $1,000.
* To identify the parties, especially if the parties have changed names.

* To imply or incorporate a term of the contract.

In order for evidence to fall under this rule, it must involve a communication made prior to the execution of the written contract, and must be evidence as to the terms of the agreement itself. Evidence of a later communications will not be barred by this rule, as it is admissible to show a later modification of the contract. Similarly, evidence of a collateral agreement - one that would naturally and normally be included in a separate writing - will not be barred. For example, if A contracts with B to paint B's house for $1,000, B can introduce extrinsic evidence to show that A also contracted to paint B's car for $100. The agreement to paint the car would logically be in a separate document from the agreement to paint the house.

Integration Clause

An **integration clause**, in the contract law, is a term in the language of the contract that declares it to be the complete and final agreement between the parties. The existence of such a term is conclusive proof that no varied or additional conditions exist with respect to the performace of the contract beyond those that are in the writing. A contract that has such a clause is deemed an integrated contract, and any previous negotiations in which the parties to the contract had considered different terms will be deemed superseded by the final writing. Sometimes is also known as "Entire Agreement" Clause, and, in its case, it is usually drafted at the end of the contract.

Excuses for Non-Performance

Mistake

In contract law a **mistake** is incorrect understanding by one or more parties to a contract and may be used as grounds to invalidate the agreement. Common law has identified three different types of mistake in contract: **unilateral mistake, mutual mistake, and common mistake**.

Unilateral mistake

A unilateral mistake is where only one party to a contract is mistaken as to the terms or subject-matter. The courts will uphold such a contract unless it was determined that the non-mistaken party was aware of the mistake and tried to take advantage of the mistake.

The leading case on unilateral mistake is Smith v. Hughes (1871).

Mistake of identity

It is also possible for a contract to be voidable if there was a mistake in the identity of the contracting party. In the leading English case of Lewis v Avery [1971] 3 All ER 907 Lord Denning held that the contract can only be avoided if the plaintiff can show, that at the time of agreement, the plaintiff believed the other party's identity was of vital importance. A mere mistaken belief as to the credibility of the other party is not sufficient.

Mutual mistake

A mutual mistake is when both parties of a contract are mistaken as to the terms. Each believe they are contracting to something different. The court usually tries to uphold such a mistake if a reasonable interpretation of the terms can be found.

The famous case of the Peerless ship is an example in the case of Raffles v. Wichelhaus, (1864) 2 Hurl. & C. 906. The defendant had made an order for the purchase of cotton for goods arriving on a certain boat Peerless from Bombay leaving in October. However a different boat arrived called Peerless, also from Bombay, but having left in December. The plaintiff merchant sought to enforce the contract for the sale of cotton, but the defendant refused stating that it was not the cotton that he had ordered. The court stated that reasonable meaning must be found. However, on the facts, there was no single reasonable interpretation of the terms, both parties were equally mistaken, thus the contract was void.

Common mistake

A common mistake is where both parties hold the same mistaken belief of the facts.

The House of Lords case of Bell v. Lever Brothers Ltd. established that common mistake can only void a contract if the mistake of the subject-matter was sufficiently fundamental to render its identity different from what was contracted, making the performance of the contract impossible.

Later in Solle v. Butcher, Lord Denning added requirements for common mistake in equity, which loosened the requirements to show common mistake. However, since that time the case has been heavily criticized in cases such as Great Peace.

Misrepresentation

In contract law, a **misrepresentation** is when a party to a contract makes a representation by words or conduct that conveys a false or misleading understanding that has the effect of inducing a party in entering the contract. For example, under certain circumstances, false statements or promises made by a seller of goods regarding the quality or nature of the product that the seller has may constitute mispresentation. A finding of misrepresentation allows for a remedy of recission and sometimes damages depending on the type of misrepresentation.

Representation is not a term

To seek a remedy under misrepresentation it must first be determined that the representation is not a term of the contract (i.e. a warranty). This is determined objectively by the trier of fact by looking at the time that the representation was made, the closer to the moment of contract formation the more likely it is a term, and if there is any mention of the representation in writing that could be construed as part of the contract.

As well, the Courts will often attempt to find a collateral contract by interpreting the representation as a promise accompanied by some sort of consideration (see Heilbut, Symons & Co. v. Buckleton [1913] A.C. 30 (H.L.)). The collateral contract will have the effect of adding the representation as a term to the contract.

If the representation is found to be a term then the normal remedies for breach of contract apply.

Types of misrepresentation

Fraudulent misrepresentation is when the representation made with intent to deceive and with the knowledge that it is false. This is generally a difficult type of misrepresentation to prove but allows for a remedy of both damages and recission. An action for fraudulent misrepresentation can also be brought as a tort.

Innocent misrepresentation is when the representation is made with an honest belief that it is true. This type of representation only allows for a remedy of recision.

Negligent misrepresentation is when the representation is made carelessly. This class of misrepresentation is relatively new and was introduced in order to allow for a remedy of damages in situations where neither a collateral contract nor fraud could be found. It was first seen in the case of Hedley Byrne v. Heller [1964] A.C. 465 where the court found that a statement made negligently that was relied upon can be actionable in tort. Lord Denning in Esso Petroleum Co. Ltd. v. Mardon [1976] Q.B. 108 however, transported the tort into contract law, stating the rule as:

if a man, who has or professes to have special knowledge or skill, makes a representation by virtue thereof to another...with the intention of inducing him to enter into a contract with him, he is under a duty to use reasonable care to see that the representation is correct, and that the advice, information or opinion is reliable

Frustration of Purpose

Frustration of purpose is a term used in the law of contracts to describe a defense to an action for non-performance based on the occurance of an unforseen event which makes performance impossible or commercially impracticable. A common situation is that the subject matter of the contract - a house or a car for example - is unintentionally destroyed.

Generally, the non-performance is not excused. If the seller retained the risk of loss from damage or destruction, then the non-performance will likely be excused. However, if it is the buyer who carries the risk of loss, performance will not not excused. A seller will not be excused for nonperformance of an agreement to deliver a commodity. For example, if A agrees to sell B 100 bushels of corn, and A's own crops are destroyed in an accident, A is still contractually obliged to sell B 100 bushels of corn because A can still obtain the corn elsewhere for the sale.

Frustration of purpose also arises as a defense where one party to the contract dies, if that party was uniquely necessary to the performance of the contract. Passage of a subsequent law that makes performance illegal will also excuse nonperformance under this doctrine.

Impossibility

Impossibility is an excuse for non-performance of duties under a contract, based on a change in circumstances (or the discovery of preexisting circumstances) that makes performance of the contract literally impossible. For such a defense to be raised, performance must not merely be difficult or unexpectedly costly for one party; there must be no way for it to actually be accomplished.

For example, if Rachel offers to pay Joey $500 to paint her house on October 1, but the house burns to the ground before the end of September, Rachel is excused from her duty to pay Joey the $500, and he is excused from the duty to paint her house.

Illegality

An **illegal agreement**, under the common law of contract, is one that the courts will not enforce because the purpose of the agreement is to achieve an illegal end. The illegal end must result from performance of the contract itself, however. A contract that requires only legal performance, such as the sale of packs of cards to a known gambler, where gambling is illegal, will nonetheless be enforceable. A contract to pay a gambling debt, however, will not.

A famous example in the United States is Bovard v. American Horse Enterprises 247 Cal. Rptr. 340 (1988), in which the California Supreme Court refused to enforce a contract for payment of promisory notes used for the purchase of a company that manufactured drug paraphenalia.

Unconscionability

Unconscionability is a term used in contract law to describe a defense against the enforcement of a contract based on the presence of terms unfair to one party. Typically, such a contract is held to be unenforceable because the consideration offered is lacking or is so obviously inadequate that to enforce the contract would be unfair to the party seeking to escape the contract.

In and of itself, inadequate consideration is not enough to make a contract unenforceable. However, a court of law will consider evidence that one party to the contract took advantage of its superior bargaining power to insert provisions that make the agreement overwhelmingly favor the interests of that party. In such circumstances, the fact that the consideration was lower than what would ordinarily be expected in the circumstances will often result in the court refusing to allow the contract to be enforced.

Typical scenarios

There are several typical scenarios in which unconscionability is most frequently found:

1. Where a party that typically engages in sophisticated business transactions inserts boilerplate language into a contract containing terms unlikely to be understood or appreciated by the average person. Such terms might include a disclaimer of warranties, or a provision extending liability for a newly purchased item to goods previously purchased from the same seller.
2. Where a seller offers a contract of adhesion for the purchase of necessary goods (e.g. food, shelter, means of transportation).
3. Where a seller is vastly inflating the price of goods, particularly where this inflation is conducted in a way that conceals from the buyer the total cost for which the buyer will be liable.

For the defense of unconscionability to apply, the contract has to have been unconscionable at the time that it was made - later circumstances that have the effect of making the contract extremely one-sided are irrelevant. An interesting aspect of unconscionablity is that the determination is made by the judge, not by a jury, despite the fact that such a determination is very fact-intensive.

Case law

English case law

The leading case on this point is considered to be the English case of Lloyd's Bank v. Bundy. In that case, Bundy had agreed to increase the mortgage on his house in order to maintain the credit line being extended to his son's business. The English Court of Appeal ruled that as Bundy received no direct benefit from the agreement to increase the mortgage amount, and that the bank had threatened to call in the son's loan if Bundy had not agreed to the extension, and that the amount of the loan was already higher than the existing mortgage, that the transaction was unconscionable and Bundy only had to honor the lower mortgage. Essentially, the court ruled that only the bank benefitted from the agreement to raise the amount of the mortgage.

Canadian case law

In a Canadian case, a member of the First Nations was allowed to rescind a contract for the sale of his boat and fishing license for a nominal amount. The boat was worthless but, unknown to the native, his fishing license was worth a great deal of money, and could have been mortgaged to finance a new boat. The court ruled that the buyer was merely trying to take advantage of the seller's lack of knowledge of the value of the license and refused to allow the contract to be enforced.

However, sorely inadequate consideration in and of itself is not a determination of whether a transaction is unconscionable. For example, in an Ontario case, a property owner agreed to sell an option for the sale of his property for the sum of $1.00. The owner later learned that options to purchase property usually sell for more than nominal sums. The court enforced the contract in favor of the option holder, ruling that the negotiations over the price of the option and the price the option holder would pay for the house if he chose to buy were both fairly negotiated and that the seller had adequate opportunity to investigate the market and simply did not do so.

Australian case law

The leading Australian case is Commercial Bank of Australia Ltd v. Amadio (1983) 151 CLR 447. In this case, an elderly Italian couple with little command of English secured their son's debts arising from his failing business. Their son misled them as to the extent of the guarantee, and the bank did nothing to explain it to the parents. When the son's business failed, the Amadios had the contract set aside due to unconscionable dealing by the bank. Key elements that were relied upon were:

1. The parties must meet on unequal terms, such that one party has a disability vis a vis the other party, through such things as infirmity, age and language.
2. The stronger party knows of the special disability, or should have been aware of the special disability, and takes advantage of it.
3. The stronger party obtains a bargain which would be unconscionable to retain.

Legislation

United States legislation

In the United States, the concept is established in **Section 2-302 of the Uniform Commercial Code**.

Accord & Satisfaction

Accord and satisfaction is the purchase of the release from a debt obligation. The payment is typically less than what is owed and is not paid by the actual performance of the original obligation. The accord is the agreement to discharge the obligation and the satisfaction is the legal "consideration" which binds the parties to the agreement.

If a person is sued over an alleged debt they bear the burden of proving the affirmative defense of accord and satisfaction Affirmative defense.

Rights of Third Parties

Assignment

An **assignment** is a term used with similar meanings in the law of contracts and in the law of real estate. In both instances, it encompasses the transfer of rights held by one party - the assignor - to another party - the assignee. The legal nature of the assignment determines some additional rights and liabilities that accompany the act.

Assignment of contract rights

Assignment of rights under a contract is the complete transfer of the rights to receive the benefits accruing to one of the parties to that contract. For example, if party A contracts to wash party B's car for $10, party A can later assign the benefits of the contract - the right to be paid $10 - to party C. In this scenario, party A has become the assignor, party B has become an obligor, and party C is the assignee. Such an assignment may be donative (essentially given as a gift), or it may be contractually exchanged for consideration. It is important to note, however, that party C is not a third party beneficiary, because the contract itself was not made for the purpose of benefitting party C.

When assignment will be permitted

The common law favors the freedom of assignment, so an assignment will generally be permitted unless there is an express prohibition against assignment in the contract. Where assignment is thus permitted, the assignor need not consult the other party to the contract. An assignment can not have any effect on the duties of the other party to the contract, nor can it reduce the possibility of the other party receiving full performance of the same quality. Certain kinds of performance, therefore, can not be assigned, because they create a unique relationship between the parties to the contract. For example, if party A contracts to hire an attorney to represent party A in a civil case for a fee of $1000, party A can not then assign his contractual right to legal representation to another party.

Requirements for an effective assignment

For assignment to be effective, it must occur in the present. No specific language is required to make such an assignment, but the assignor must make some clear statement of intent to assign clearly identified contractual rights to the assignee. A promise to assign in the future has no legal effect. Although this prevents a party from assigning the benefits of a contract that has not yet been made, a court of equity may enforce such an assignment where an established economic relationship between the assignor and the assignee raised an expectation that the assignee would indeed form the appropriate contract in the future.

A contract may contain a non-assignment clause, which prohibits the assignment of specific rights, or of the entire contract, to another. However, such a clause does not necessarily destroy the power of either party to make an assignement. Instead, it merely gives the other party the ability to sue for breach of contract if such an assignment is made. However, an assignment of a contract containing such a clause will be ineffective if the assignee knows of the non-assignment clause, or if the non-assignment clause specifies that "all assignments are void".

Two other techniques to prevent the assignment of contracts are recission clauses or clauses creating a condition subsequent. The former would give the other party to the contract the power to rescind the contract if an assignment is made; the latter would rescind the contract automatically in such circumstances.

Requirement of a writing

There are certain situations in which the assignment must be in writing.

1. Assignment of wages
2. Assignment of any interest in real property
3. Assignment of choses of action worth over $5,000
4. Assignment as collateral for a loan or debt

Revocability

Assignments made for consideration are irrevocable, meaning that the assignor permanently gives up the legal right take back the assignment once it has been made. Donative assignments, on the other hand, are generally revokable, either by the assignor giving notice to the assignee, taking performance directly from the obligor, or making a subsequent assignment of the same right to another. There are some exceptions to the revocability of a donative assignment:

1. The assignment can not be revoked if the obligor has already performed
2. The assignment can not be revoked if the assignee has received a token chose (chose being derived from the French word for "thing", as in a chose of action) - a physical object that signifies a right to collect, such as a stock certificate or the passbook to a savings account.
3. The assignment can not be revoked if the assignor has set forth in writing the assignment of a simple chose - a contract right not embodied in any for of token.
4. Estoppel can prevent the revocation of a donative assignment if the asignee changed their position in reliance on the assignment.

Finally, the death or declaration of bankruptcy by the assignor will automatically revoke the assignment by operation of law.

Breach and defenses

A cause of action for breach on the part of the obligor lie with the assignee, who will hold the exclusive right to commence a cause of action for any failure to perform or defective performance. At this stage, because the assignee "stands in the shoes" of the assignor, the obligor can raise any defense to the contract that the obligor could have raised against the assignor. Furthermore, the obligor can raise against the assignee counterclaims and setoffs that the obligor had against the assignor. For example, suppose that A makes a contract to paint B's house in exchange for $500. A then assigns the right to receive the $500 to C, to pay off a debt owed to C. However, A does such a careless job painting the house that B has to pay another painter $400 to correct A's work. If C sues B to collect the debt, B can raise his counterclaim for the expenses caused by the poor paint job, and can reduce the amount owed to C by that $400, leaving only $100 to be collected.

When the assignor makes the assignment, he makes with it an implied warranty that the right to assign was not subject to defenses. If the contract had a provision that made the assignment ineffective, the assignee could sue the assignor for breach of this implied warraney. Similarly, the assignee could also sue under this theory if the assignor wrongfully revoked the assignment.

Successive assignments

Occasionally, an unscrupulous assignor will assign the exact same rights to multiple parties (usually for some consideration). In that case, the rights of the assignee depend on the revocability of the assignment, and on the timing of the assignments relative to certain other actions.

In a quirk left over from the common law, if the assigment was donative, the last assignee is the true owner of the rights. However, if the assignment was for consideration, the first assignee to actually collect against the assigned contract is the true owner of the rights. Under the modern American rule, now followed in most U.S. jurisdictions, the first assignor with equity (i.e. the first to have paid for the assignment) will have the strongest claim, while remaining assignees may have other remedies.

1. Earlier donative assignees for whom the assignment was revocable (because it had not been made irrevocable by any of the means listed above) have no cause of action whatsoever.
2. Earlier donative assignees for whom the assignment was made irrevocable can bring an action for the tort of conversion, because the assignment was technically their property when it was given to a later assignee.
3. Later assignees for consideration have a cause of action for breaches of the implied warranty discussed above.

Compare: Delegation

A parallel concept to assignment is delegation, which occurs when one party transfers his duties or liabilities under a contract to another. A delegation and an assignment can be accomplished at the same time, although a non-assignment clause also bars delegation.

Delegation

Delegation is a term used in the law of contracts to describe the act of giving another person the responsibility of carrying out the performance agreed to in a contract. Three parties are concerned with this act - the party who had incurred the obligation to perform under the contract is called the delegator; the party who assumes the responsibility of performing this duty is called the delegatee; and the party to whom this performance is owed is called the obligee.

Delegable contracts

A delegation will be null and void if it poses any threat to the commercially reasonable expectations of the obligee. For example, a task requiring specialized skills or based on the unique characteristics of the promisee can not be delegated. If Bill Clinton were hired to make a speech, he could not delegate the task to another person, even if the other person would give the same speech, word for word.

However, a delegation of performance that does not pose such a threat will be held to be valid. In such a case, the obligee will under an affirmative duty to cooperate with the delegatee to the extent necessary for the fulfillment of the delegator's obligations under the contract.

Breach of a delegated contract

If the delagatee fails to perform satisfactorily, the obligee may elect to treat this failure as a breach of the original contract by the delegator or may assert himself as a third party beneficiary of the contract between the delagator and the delegatee, and can claim all remedies due to a third party beneficiary.

If the delegation is without consideration, the delagator remains liable for nonperformance, while the delagatee will not be liable to anyone for anything. Unlike an assignment, a delegation is virtually always for consideration, and never donative - few people are going to accept the charitable offer to perform a task contracted to someone else.

Compare: assignment

A parallel concept to delegation is assignment , which occurs when one party transfers his present rights to receive the benefits accruing to the assignor under that contract. A delegation and an assignment can be accomplished at the same time, although the right to sue for nonpayment always stays with delagator. Under the common law, a contract clause prohibiting assignment also prohibits delegation. Another common law rule requires that a party to a contract can not delegate performance that involves special skills or reputation (although it is possible to have a novation under such circumstances).

Novation

Novation is a term used in contract law and business law to describe the act of either replacing an obligation to perform with a new obligation, or replacing a party to an agreement with a new party. A novation must be agreed upon by all original parties to the original agreement.

Novation is also used in futures/options trading markets to describe a special situation where the clearing house takes all positions with all the brokers, buying all the brokers sell, and selling all that the brokers buy.

In business, novation is typically the process by which a newly formed corporation assumes the pre-incorporation liabilities incurred by its founders.

Third Party Beneficiary

A **third party beneficiary**, in the law of contracts, is a person who may have the right to sue on a contract, despite not having originally been a party to the contract. This right arises where the third party is the intended beneficiary of the contract, as opposed to an incidental beneficiary. It vests when the third party relies on or assents to the relationship, and gives the third party the right to sue either the promisor or the promisee of the contract, depending on the circumstances under which the relationship was created.

Intended vs. incidental beneficiary

In order for a third party beneficiary to have any rights under the contract, he must be an intended beneficiary, as opposed to an incidental beneficiary. The burden is on the third party to plead and prove that he was indeed an intended beneficiary.

Incidental beneficiary

An incidental beneficiary is a party who stands to benefit from the execution of the contract, although that was not the intent of either party. For example, if party A hires party B to rennovate party A's house, and insists that party B use a particular house painter - party C - because that house painter has an excellent reputation, then the house painter is an incidental beneficiary. Neither party A nor party B is entering into the contract with the particular intent to benefit party C. A simply wants his house properly rennovated; B simply wants to be paid to do the rennovation. If the contract is breached by either party in a way that results in party C never getting hired for the job, party C nonetheless has no rights to recover anything under the contract. Similarly, if party A were to promise to buy party B a Cadillac, and were to later go back on that promise, General Motors would have no grounds upon which to recover for the lost sale.

Intended beneficiary

The distinction that creates an intended beneficiary is that one party - called the promisee - makes an agreement to provide some consideration to a second party - called the promisor - in exchange for the promisor's agreement to provide some product, service, or support to the third party beneficiary named in the contract. The promisee must have an intention to benefit the third party - but this requirement has an unusual meaning under the law. Although there is a presumption that the promisor intends to promote the interests of the third party in this way, if party A contract with party B to have a thousand killer bees delivered to the home of Party A's worst enemy, party C, then C is still considered to be the intended beneficiary of that contract.

There are two common situations in which the intended beneficiary relationship is created. One is the creditor beneficiary, which is created where party A owes some debt to party C, and party A agrees to provide some consideration to party B in exchange for party B's promise to pay party C some part of the amount owed.

The other is the donee beneficiary, which is created where party A wishes to make a gift to party C, and party A agrees to provide some consideration to party B in exchange for party B's promise to pay party C the amount of the gift. Under old common law principles, the donee beneficiary actually had a greater claim to the benefits this created; however, such distinctions have since been abolished.

Vesting of rights

Once the beneficiary's rights have vested, the original parties to the contract are both bound to perform the contract. Any effort by the promisor or the promisee to rescind or modify the contract at that point are void. Indeed, if the promisee changed his mind and offered to pay the promisor money not to perform, the third party could sue the promisee for tortious interference with the third party's contract rights.

There are three tests used to determine whether the third party beneficiary's rights have vested:

1. if the beneficiary knows of and has detrimentally relied on the rights created
2. if the beneficiary has expressly assented to the contract at the request of one of the parties
3. if the beneficiary files a lawsuit to enforce the contract

Breach and defenses

Where a contract for the benefit of a third party is breached by the non-performance of the promisor, the beneficiary can sue the promisor for the breach just as any party to a contract can sue the other. Because the rights of the third party are defined by the contract created between the promisor and the promisee, the promisor may assert against the beneficiary any defenses to the contract that could be asserted against the promisee. These include all of the traditional basis by which the formation of a contract may be challenged: lack of capacity, lack of consideration, the Statute of Frauds, etc.; and all of the traditional bases by which non-performance on the contract may be excused: failure of consideration, impossibility, illegality, frustration of purpose, etc.

Because the promisor can assert any defenses that could be asserted against the promisee, the beneficiary also becomes liable for counterclaims on the contract that the promisor could establish against the promisee. This liability can never exceed the amount that the promisor owes under the contract. In other words, if the promisor is owed money by the promisee, any award to the third party for the promisor's failure to perform can be reduced by the amount thus owed. If the promisor is owed more than the value of the contract, the beneficiary's recovery will be reduced to nothing (but the third party can never be made to assume an actual debt).

A creditor beneficiary can sue both the promisor and the promisee, but the beneficiary can not recover against both. If the suit is successful against one party to the contract, the other party will be dismissed. Because the creditor beneficiary is receiving the performance of the promisor in order to fulfill the promisee's debt, the failure of the promisor to perform means that the beneficiary can still sue the promisee to recover the preexisting debt. The failure of performance simply means that the debt has never been paid.

A donee beneficiary can not sue the promisee, because the promisee's act is gratuitous. Courts simply will not allow a party who has been promised a gift to sue to compel delivery of the gift. However, if the beneficiary has relied to his detriment on the promisee's assertion that the promisor would perform, the beneficiary may sue the promisee under a promissory estoppel theory.

Rights that accrue to the promisee

The promisee can also sue the promisor for failing to pay the third party beneficiary. Under the common law, such suits were barred, but courts have since determined that the promisee can sue for specific performance of the contract, provided that the beneficiary has not already sued the promisor. Furthermore, if the promisee was in debt to a creditor beneficiary, and the failure of the promisor to perform caused the promisee to be held liable for that debt, the promisee can sue to recover the amount of the debt.

Breach of Contract

Anticipatory Repudiation

Anticipatory repudiation (or **anticipatory breach**) is a term in the law of contracts that describes a declaration by one party (the promissing party) to a contract that they do not intend to live up to their obligations under the contract. Where such an event occurs, the other party (the performing party) to the contract is excused from having to fulfill their obligations. However, the repudiation can be retracted by the promising party so long as there has been no material change in the position of the performing party in the interim. A retraction of the repudiation restores the performer's obligation to perform on the contract.

If the repudiation occurs by the promising party making it impossible to fulfill their promise, then no act by the promising party can restore the performer's obligation to perform on the contract. For example, if A promises to give B a unique sculpture in exchange for B painting A's house, but A then sells the sculpture to C before B completes the job, this act by A constitutes an anticipatory repudiation which excuses B from completing the job. Once the sculpture has left A's possession, there is no way that A can fulfill the promise to give the sculpture to B.

Cover

Cover is a term used in the law of contracts to describe a remedy available to a merchant buyer who has received an anticipatory repudiation of a contract for the receipt of goods. Under the Uniform Commercial Code, the buyer is permitted (but not required) to find another source of the same type of goods. The buyer may then file a lawsuit against the breaching seller to recover the difference, if any, between the cost of the goods offered and the cost of the goods actually purchased.

The possibility of cover will prevent a party from being able to sue for specific performance, which is an equitable remedy that requires the buyer have no adequate remedy at law. If the buyer is able to buy elsewhere and sue for the difference, that provides an adequate remedy. This prohibition does not apply, however, to the sale of unique goods such as original works of art, collectibles, and real estate.

Judge Richard Posner has suggested that that the availability of cover allows for efficient breach - that is, that it encourages the most efficient allocation of resources by allowing a seller to breach a contract to sell goods to one buyer when another, more lucrative opportunity comes along. The seller may thus be able to realize a sufficiently increased profit to make more money even after repaying the difference to the original buyer. Therefore, no value is lost in the transaction because the original buyer is in the same position he would have been but for the breach, and the seller is in a better position.

Exclusion Clause

An **exclusion clause** is a term in a contract that seeks to restrict the rights of the parties to the contract. Exclusion clauses generally fall into one of these categories:

* **True exclusion clause**: The clause recognises a potential breach of the contract, and then excuses liability for the breach. Alternatively, the clause is constructed in such a way it only includes reasonable care to perform duties on one of the parties.
* **Limitation clause**: The clause places a limit on the amount that can be claimed for a

breach of contract, regardless of the actual loss.
* **Time limitation**: The clause states that an action for a claim must be commenced within a certain period of time or the cause of action becomes extinguished.

As espoused in Darlington Future Ltd v. Delcon Australia Pty Ltd (1986) 161 CLR 500, the meaning of an exclusion clause is construed in its ordinary and natural meaning in the context. Although we construe the meaning much like any other ordinary clause in the contract, we need to examine the clause in light of the contract as a whole.

However, if after construing the contract in its ordinary and natural meaning, there is still ambiguity in the exclusion clause, the contra proferentem rule shall apply; that is to say, the clause is contrued against the person trying to take advantage of the rule.

In terms of negligence, the decision in Canada SS Lines Ltd v. The King [1952] AC 192 held that:

* If the exclusion clauses mention "negligence" explicitly, then liability for negligence is excluded.
* If "negligence" is not mentioned, then liability for negligence is excluded only if the words used in the exclusion clause are wide enough to exclude liability for negligence. If there is any ambiguity, then the contra proferentem rule applies.
* If a claim on another basis can be made, then liability for negligence is not covered by the exclusion clause.

In Australia, the four corners rule has been adopted in preference over the idea of a fundamental breach (The Council of the City of Sydney v. West (1965) 114 CLR 481). The court will presume that parties to a contract will not exclude liability for losses arising from acts not authorised under the contract. However, if acts of negligence occur during authorised acts, then the exclusion clauses shall still apply.

If the contract is for the carriage of goods, if the path is deviated from what was agreed, any exclusion clauses no longer apply.

Fundamental Breach

Fundamental breach, sometimes known as a repudiatory breach, is a breach so fundamental that it permits the aggrieved party to terminate performance of the contract, in addition to entitling that party to sue for damages.

United Kingdom

In English law, fundamental breach was first examined by the House of Lords in the Suisse Atlantique case [1966] 2 All E.R. 61, wherein they decided that a contract can be voided if a breach of a fundamental term can be found. That is, a breach of a condition that "goes to the root of the contract". This approach is known as the Rule of Law doctrine.

At the Court of Appeal level in Photo Productions Ltd. v. Securicor Transport Ltd. [1978] 1 W.L.R. 856 Lord Denning championed the Rule of Law doctrine and extended the rule in Suisse Atlantique case to apply to all exemption clauses. However on appeal to the House of Lords Lord Wilberforce effectively overturned the Rule of Law doctrine and instead maintained a strict Rule of Construction approach whereby a fundamental breach is found only through examining the reasonable intentions of the parties at the time of the contract.

Canada

The leading case on fundamental breach in Canada is the case of Hunter Engineering Co. v. Integrated Metal Systems Ltd. [1989] 3 W.W.R. 385. In it they adopt similar reasoning as the House of Lords in Photo Productions, ruling that a fundamental breach is found through rule of construction only.

The court should not disturb the bargain the parties have struck, and I am inclined to replace the doctrine of fundamental breach with a rule that holds the parties to the terms of their agreement, provided the agreement is not unconscionable ... Only where the contract is unconscionable, as might arise from situations of unequal bargaining power between the parties, should the courts interfere with agreements the parties have freely concluded.'

Remedies

Liquidated Damages

Liquidated damages is a term use in the law of contracts to describe a contractual term which establishes damages to be paid to one party if the other party should breach the contract. Under the common law, a liquidated damages clause will not be enforced if the purpose of the term is solely to punish a breach of contract (in this case it is a penal clause). This is because such a clause does not allow the court to determine actual damages, and its enforcement would therefore require an equitable order of specific performance. However, courts sitting in equity will seek to achieve a fair result, and will not enforce a term that will lead to the unjust enrichment of the enforcing party.

In order for a liquidated damages clause to be upheld, two conditions must be met. First, the amount of the damages identified must roughly approximate the damages likely to fall upon the party seeking the benefit of the term. Second, the damages must be sufficiently uncertain at the time the contract is made that such a clause will likely save both parties the future difficulty of estimating damages.

For example, suppose Joey agrees to lease a storefront to Monica, from which Monica intends to sell jewelry. If Joey breaches the contract by refusing to lease the storefront at the appointed time, it will be difficult to determine what profits Monica will have lost, because the success of newly created small businesses is highly uncertain. This, therefore, would be an appropriate circumstance for Monica to insist upon a liquidated damages clause in case Joey does indeed fail to perform.

Penal Damages

Penal damages are best seen as quantitatively excessive liquidated damages and are invalid under the common law. While liquidated damages are a priori calculations of expectation loss under the contract, penal damages go further and seek to penalise a party in some way for breach of a clause above and beyond the loss suffered by the innocent party as a result of this breach. Many clauses which are found to be penal are expressed as liquidated damages clauses but are seen by courts as excessive and thus invalid.

The judicial approach to penal damages is conceptually important as it is one of the few examples of judicial paternalism in contract law. Even if two parties genuinely and without coercion wish to consent to a contract which includes a penal clause, they are unable to. So, for example, a person wishing to give up smoking cannot contract with a third party to be fined $100 each time they smoke as this figure does not represent the expectation loss of the contract.

Specific Performance

In the law of remedies, a **specific performance** is a demand of a party to perform a specific act. While specific performance can be in the form of any type of forced action, it is usually used to complete a previously established transaction. It is the opposite of an injunction. Under the common law, specific performance was not a remedy, with the rights of a litigant being limited to the collection of damages. However, the courts of equity developed the remedy of specific performance as damages often could not adequately compensate someone for the inability to own a particular piece of real property, land being regarded as unique. Specific performance is often guaranteed through the remedy of a writ of possession, giving the plaintiff the right to take possession of the property in dispute. However, in the case of personal performance contracts, it may also be ensured through the threat of proceedings for contempt of court.

In practice, specific performance is most often used as a remedy in transactions regarding land, such as in the sale of land where the vendor refuses to convey title.

In cases where the ownership of land is in dispute, the plaintiff can often obtain a certificate of lis pendens to advise any prospective purchaser of the property that the person holding legal title may not have good equitable title to the property. However, if the plea for specific performance is denied, filing such a lis pendens constitutes a slander of title, which may allow the defendant to sue for any profit lost from his inability to sell the land.

However, the limits of specific performance in other contexts are narrow. Moreover, performance that is based on the personal judgment or abilities of the party on which the demands are made is rarely ordered by the court. The reason behind it is that the forced party will often perform below their regular standard when it is in their ability to do so. Monetary damages are usually given instead.

Traditionally, equity would only grant specific performance with respect to contracts involving chattels where the goods were unique in character, such as art, heirlooms, and the like. The rationale behind this was that with goods being fungible, the aggrieved party had an adequate remedy in damages for the other party's non-performance.

Article 2 of the Uniform Commercial Code displaces the traditional rule in an attempt to adjust the law of sales of goods to the realities of the modern commercial marketplace. If the goods are identified to the contract for sale and in the possession of the seller, a court may order that the goods be delivered over to the buyer upon payment of the price. This is termed replevin. In addition, the Code allows a court to order specific performance where "the goods are unique or in other proper circumstances", leaving the question of what circumstances are proper to be developed by case law.

Rescission

In contract law, **rescission** (to **rescind** or **set aside** a contract) refers to the cancellation of the contract between the parties. This is done to bring the parties as far as possible to the position they were before they entered into a contract. This an equitable remedy and is discretionary. The court may decline to rescind a contract if one party has affirmed the contract by his action (see Long v Lloyd) or a third party has acquired some rights or there has been substantial performance in implementing the contract.