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ESSENTIAL CONTRACT LAW

Second Edition



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ESSENTIAL CONTRACT LAW

Second Edition

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Foreword

This book is part of the Cavendish Essential Series. The books in the series constitute a unique publishing venture for Australia in that they are intended as a helpful revision aid for the hard-pressed student. They are not intended to be a substitute for the more detailed textbooks which are already listed in the current Cavendish catalogue.

Each book follows a prescribed format consisting of a checklist covering each of the areas in the chapter, and an expanded treatment of 'Essential' issues looking at examination topics in depth.

The authors are all Australian law academics who bring to their subjects a wealth of experience in academic and legal practice.

*Professor David Barker
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Preface

This book is intended as a revision aid for students studying tertiary courses in law. As space is limited, the book only covers the broad topic areas referred to in the 'Priestley 11' prescription for 'Contracts' that are found in the contract law syllabi of accredited law schools.

The law is stated as it was on 1 February 2001.

The cases referred to in this book include references to the following courts:

Australian courts:

- (HC) High Court of Australia
- (Fed) Federal Court of Australia
- (NSW) Supreme Court of New South Wales
- (Vic) Supreme Court of Victoria
- (Qld) Supreme Court of Queensland
- (SA) Supreme Court of South Australia
- (WA) Supreme Court of Western Australia
- (Tas) Supreme Court of Tasmania
- (NT) Supreme Court of the Northern Territory
- (ACT) Supreme Court of the Australian Capital Territory

New Zealand courts:

- (NZ) High Court of New Zealand

United Kingdom courts:

- (PC) Privy Council
- (HL) House of Lords
- (CA) Court of Appeal
- (KB) King's Bench Division
- (QB) Queen's Bench Division
- (Ch) Chancery Division
- (Ex) Exchequer Chamber
- (CCP) Court of Common Pleas

United States of America courts:

- (US) Supreme Court of the United States

My thanks to Susan Carr-Gregg (1st and 2nd editions), Amanda Leung (1st edition) and David Spencer (2nd edition) for their comments and suggestions.

This book is dedicated to my students and teaching colleagues.

Enjoy your studies in contract law.

Geoff Monahan
February 2001

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1 Introduction

You should be familiar with the following areas:

- what constitutes a valid contract
- effect of a void contract
- effect of a voidable contract
- effect of an unenforceable contract

Overview

The law of contract is of crucial importance in the legal management of transactions and obligations in our economic system. Essentially, a contract is an agreement between two or more parties that the law will enforce. Generally speaking, damages (that is, compensation) are payable for loss suffered by one party due to the non-performance (or poor performance) by the other party to the contract. Moreover, a party may (in appropriate circumstances) request a civil court to order performance by the other party in default.

At common law (that is, judge made law), the same legal principles generally apply to all types of contracts. Over time, the strict application of the common law has become somewhat subdued by the principles of equity, designed by the courts to restrain unconscionable contractual outcomes and promote justice.

More recently, statute (that is, Parliament made law) has altered or replaced the common law in relation to various aspects of contract law, in particular contracts for consumer goods and services.

Terminology

Valid contract

A valid contract is a contract that the law will enforce and creates legal rights and obligations. A contract valid *ab initio* (from the beginning) contains all the three essential elements of formation:

- agreement (offer and acceptance);
- intention (to be bound by the agreement);
- consideration (for example, the promise to pay for goods or services received).

In addition, a valid contract may have to be in writing to be legally valid (although most contracts may be oral, or a combination of oral and written words).

Void contract

A void contract lacks legal validity and does not create legal rights or obligations. A contract that lacks one or more of the essential formation elements is void *ab initio* (from the beginning). In other words, the law says that it is not, or never was, a valid contract.

Voidable contract

A voidable contract is a valid contract that contains some defect in substance or in its manner of formation that allows one party (or sometimes both parties) to rescind it. A voidable contract remains valid and can create legal rights and obligations until it is rescinded. The party with the right to rescind may lose that right by affirmative conduct, or undue delay, or where the rights of an innocent third party may be harmed.

Unenforceable contract

An unenforceable contract is an otherwise valid contract that contains some substantive, technical or procedural defect. Most commonly, such a contract is illegal, either in its formation or its performance, as it offends either public policy (the common law) or some statute. As a general rule, the law will not allow the enforcement of such a contract

(or may only allow the innocent party the right to enforce). Alternatively, the law may determine that such a contract is void (rather than unenforceable) with the consequential loss of contractual rights.

2 Agreement

You should be familiar with the following areas:

- what constitutes a valid offer
- termination of a valid offer
- what constitutes a valid acceptance
- certainty of terms and incomplete agreements

Agreement is the first essential element of contract formation. A binding agreement involves a meeting of the minds (*consensus ad idem*) and a contract may be achieved by the acceptance of an offer.

Offer

Defining an 'offer'

An offer may be described as a final statement or proposal by one person (offeror) to another person (offeree). The statement or proposal is usually made on certain terms and often follows a process of negotiation. In other words, an offer only exists when there is nothing further to negotiate – either the offer is accepted or it is rejected.

Whether a statement amounts to an offer depends upon whether the offeree would reasonably interpret it as an offer. This is an objective test and not a subjective test of what the actual offeree thought. There are a number of rules that have been developed to assist in determining whether an offer has been made. A valid offer:

- must be communicated by the offeror to the offeree;
- may be made to a particular person, a group of persons, or to the entire world;
- must be clear and unequivocal;
- must be distinguished from 'mere puffs', a request for further information, or an 'invitation to treat'.

Offer must be communicated

An offer is ineffective until it is communicated by the offeror to the offeree. If the offeree is unaware of an offer, then it would be impossible to accept it. In *R v Clarke* (1927) (HC), the court held that Clarke could not claim a reward for information he had given because, at the time he gave the information, he was unaware that a reward had been offered.

Offer may be unilateral

In *Carlill v Carbolic Smoke Ball Co* (1893) (CA), the plaintiff (Carlill) saw a newspaper advertisement placed by the defendant (Carbolic) claiming that their 'smoke ball' would cure all sorts of illnesses including influenza. More importantly, the advertisement also stated that the defendants offered to pay £100 to any person who used one of their smoke balls and then succumbed to influenza within a specified time. The plaintiff purchased their smoke ball and subsequently came down with a nasty bout of the 'flu. She sued the defendant for the £100. The defendant argued, *inter alia*, that an offer must be made bilaterally (that is, an offer can not be made to the entire world). The court disagreed and held that an offer can be made unilaterally (that is, an offer can be made to the entire world).

Mere puffs

Offers must be distinguished from non-promissory statements made during the course of negotiations. Objectively, these statements are exaggerated and a reasonable person would not expect them to be true. For example, no reasonable person would believe that a toothpaste can really make teeth 'whiter than white'.

Request for further information

A request for further information is not an offer. In *Harvey v Facey* (1893) (HL), the plaintiff (Harvey) sent a cable to the defendant (Facey) asking: 'Will you sell us Bumper Hall Pen? Telegraph lowest cash price.' Bumper Hall Pen was the name of a property belonging to the defendant. The defendant cabled back the reply: 'Lowest cash price for Bumper Hall Pen £900.' The plaintiff sent a further cable purporting to accept the defendant's offer. The court held that there was no agreement. The plaintiff had requested some information and the defendant had merely responded to his request. The plaintiff's further

cable did not contain an acceptance, but was an offer to buy, which the defendant refused.

Invitation to treat

An 'invitation to treat' is simply an invitation by one party to commence negotiations which may or may not lead to an offer. While an invitation to treat is not an offer, it can determine the form that a subsequent offer is to take (for example, sale by auction or tender). In other words, a person who responds to an invitation to treat is in fact making an offer, which may be accepted or rejected. The distinction between an offer and an invitation to treat depends, of course, upon the objective intention of the parties.

Display of goods for sale

Goods displayed in shops for sale are invitations to treat, notwithstanding that a price tag is attached. In *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd* (1953) (CA), the court held that, in a self-serve shop, the offer takes place at the sales counter when the shop assistant accepts the customer's offer to buy the selected goods. Putting goods on display shelves with price tags attached was not an offer that could be immediately accepted by a customer putting the goods into his or her shopping basket. Therefore, the shop display was only an invitation to treat.

Advertising goods for sale in brochures

Advertising goods in a brochure, catalogue or newspaper is generally only an invitation to treat. The reader makes the offer by placing an order or visiting the shop, and (in theory) the shop owner can either accept or reject the reader's offer. In *Grainger v Gough* (1896) (HL), a wine merchant distributed a circular that listed the prices of wines that he stocked. In holding that the circular constituted an invitation to treat, the court noted that a price list does not amount to an offer to supply an unlimited quantity of goods at the published price. A similar result occurred in the case of *Partridge v Crittenden* (1968) (CA). Of course, if the advertisement is unilateral in nature (see *Carlill v Carbolic Smoke Ball Co* above, p 6), then it may constitute an offer. In addition, there are now statutory restrictions that modify the common law in this area (see (Cth) Trade Practices Act 1974 below, p 8).

Sale by auction

In *Payne v Cave* (1789) (KB), it was held that an auctioneer who puts a property up for sale is not making an offer to sell but is issuing a request for bids. The various bids form a series of offers that the auctioneer can accept or reject on behalf of the seller. The rule is now codified with respect to goods in the Sale of Goods legislation in each State and Territory: NSW/NT/ACT, s 60; Vic, s 64; Qld, s 59; SA/WA, s 57; Tas, s 62. In *Harris v Nickerson* (1873) (QB), it was held that a notice advertising an auction on a specified date did not constitute an offer which could be accepted by turning up at the stated time.

Sale by tender

A tender is an invitation for interested persons to send in offers. The recipient of the offers (or bids) can then enter into a contract by communicating acceptance with the chosen tenderer. However, it was held in *Harvela Investments Ltd v Royal Trust Company of Canada (CI) Ltd* (1986) (HL) that if the request is made to specific persons and it is stated that the contract will be awarded to the highest or the lowest bidder (as the case may be), then this statement will be binding as a unilateral offer.

(Cth) Trade Practices Act 1974

The common law in relation to offers has been substantially modified by the (Cth) Trade Practices Act 1974, which regulates contracts entered into between consumers and corporations, and by the equivalent State and Territory Fair Trading legislation. The following sections are relevant:

- (a) misleading and deceptive conduct: s 52;
- (b) false representations: ss 53, 53A–C;
- (c) offering gifts, etc, with the intention of not providing them: s 54;
- (d) 'bait advertising': s 56;
- (e) damages: s 82;
- (f) 'other orders' (that may be imposed for contravention): s 87.

Termination of the offer

An offer may be terminated by revocation, rejection or lapse.

Revocation (termination by the offeror)

Revocation before acceptance

An offer may be withdrawn or revoked by the offeror at any time before it has been accepted. A revocation of an offer is ineffective until it is communicated to the offeree. In *Byrne and Co v Leon Van Tienhoven and Co* (1880) (CCP) (see below, p 14) the withdrawal of an offer sent by cable was held to be communicated only when the cable was received.

Indirect communication may suffice

The offeror does not have to specifically communicate the revocation. It is sufficient if the offeree learns of the revocation from a third party where a reasonable person would treat the communication from a third party seriously. In *Dickinson v Dodds* (1876) (CA), the defendant (Dickinson) wrote to the plaintiff (Dodds) agreeing to sell a farm for £800. The day before the offer was due to expire, a neighbour told the plaintiff that the defendant had decided to sell the farm to a third party. The plaintiff then purported to accept the offer before the time expired. The defendant refused to sell the farm to the plaintiff. The court held that the note was an offer (and not an option, as there was no consideration) and it could be withdrawn before acceptance. In other words, there does not have to be an express or actual withdrawal of the offer – communication through a third party will suffice.

Revocation of unilateral contracts

While there are no decided Australian or English cases, the US case *Shuey v United States* (1875) held that revocation should take place in the same form as the offer was made (for example, a newspaper advertisement).

Revocation where there has been substantial performance

It appears that a revocation will not be effective if the offeree has commenced substantial performance of a promise. In other words, once the offeree has commenced performance, that party should be given a reasonable opportunity to complete the acceptance. In *Errington v Errington* (1952) (CA), a father promised his daughter and son-in-law that if they paid off the outstanding mortgage on a house the father owned, he would transfer the ownership to them. The couple moved into the house and began the mortgage repayments. Some time later, the father died, and his widow sought to withdraw the father's offer before the mortgage had been fully repaid. The

widow was unsuccessful as the court held there was an implied term that the offer was irrevocable once performance had begun.

Rejection (termination by the offeree)

An offer is terminated once it is rejected by the offeree

Rejection of an offer need not be explicit. An offer is terminated if the offeree simply makes a counter offer. A counter offer is a response that indicates a willingness to contract but on different terms from the offer. In *Hyde v Wrench* (1840) (Ch), the defendant (Wrench) offered to sell a farm to the plaintiff (Hyde) for £1,200. When the plaintiff rejected that offer the defendant made a further offer to sell for £1,000. The plaintiff replied that he would pay £950 for it, but this was unacceptable to the defendant. The plaintiff later wrote to the defendant purporting to accept the defendant's offer to sell the farm for £1,000. The defendant subsequently refused to sell. The court held that the plaintiff had made a counter offer (that is, £950) which terminated the offer by the defendant to sell the farm for £1,000. Therefore, there was no offer for the plaintiff to accept.

A request for further information about an offer is not a counter offer

In *Stevenson, Jaques and Co v McLean* (1880) (QB), the defendant (McLean) offered to sell iron at a certain price per ton. The plaintiff (Stevenson) cabled the defendant asking whether he could pay by instalments. The defendant, believing that this request amounted to a rejection, sold the iron to someone else. The plaintiff subsequently cabled their acceptance of the defendant's offer before becoming aware of the new buyer. The court held that the plaintiff's original cable was not a rejection or counter offer but a mere request for information. Consequently, a contract had been formed and the defendant was liable.

Lapse

An offer remains open until the offeree accepts it or it lapses. When an offer lapses, it no longer legally exists and the offeree can no longer accept it. An offer may lapse in the following ways:

- through the effluxion of time;
- the death of the offeree or offeror;
- by the failure of a condition.

Effluxion of time

An offer that requires acceptance within a specified time, lapses when that time expires. An offer that contains no time limit for acceptance lapses after a reasonable time. What is reasonable depends upon the circumstances. In *Ramsgate Victoria Hotel Co Ltd v Montefiore* (1866) (Ex), the defendant (Montefiore) applied for shares in the plaintiff hotel company. Some five months later, the plaintiff allotted the shares to the defendant, but he refused to accept them. The court held that the defendant was entitled to refuse the shares because his offer had not been accepted within a reasonable time.

Death of the offeree or offeror

The death of either party before acceptance of an offer generally causes the offer to lapse. In *Fong and Cilli* (1968) (NT), the owner of certain land and one of the two joint purchasers signed the relevant contract for sale document. The owner then died before the other joint purchaser (who knew of the owner's death) signed the contract. The court held that the offer had been terminated by the known death of the offeror at the time the second joint purchaser signed the contract.

Failure of a condition

If an offer is made subject to a condition, then the offer will lapse where the condition is not satisfied. This raises the problem of conditional contracts or contracts entered into subject to a condition such as finance, formal documentation, or solicitor's approval. In *Gilbert J McCaul (Australia) Pty Ltd v Pitt Club Ltd* (1959) (NSW), the plaintiff (Pitt) entered into a contract to lease property from the defendant (McCaul) for a period of five years. The lease contained a right for the plaintiff to renew the lease for a further five years subject to two conditions being satisfied – first, the plaintiff had to give three months' notice of his intention to exercise the option and, secondly, the plaintiff had to pay rent punctually and perform all the obligations under the lease. The plaintiff gave the defendant the required three months' notice, but had not punctually paid the rent. The plaintiff sued when the defendant refused to renew the lease. The court held that the condition to pay rent punctually was a condition precedent to the plaintiff's right to exercise the option, and consequently the right lapsed.

Acceptance

Defining 'acceptance'

An acceptance is an absolute and unqualified assent to all the terms that comprise an offer. A valid acceptance:

- must be communicated by the offeree (see below);
- must be made in response to an offer (see *R v Clarke* above, p 6) and correspond with the offer. In *Evans Deakin Industries v Queensland Electricity Generating Board* (1984) (Qld), the court held that, if the offeree's acceptance seeks to vary the offer, it is usually construed as a counter offer that the original offeror may consider;
- must be made while the offer is still in force (see 'termination of the offer', above, p 8);
- may be express (oral or in writing) or implied from conduct. In *Brogden v Metropolitan Railway Co* (1877) (HL), the defendant (Brogden) had been supplying coal to the plaintiff (Metropolitan) without a formal contract. Subsequently, the defendant was sent a draft contract which, after making a minor change to it, he signed, marked 'approved' and returned to the plaintiff's agent. The plaintiff's agent received the draft contract and it was locked away in a cabinet without being executed by the plaintiff. The parties thereafter proceeded to act as if there were a binding contract until a dispute arose between them some time later. The court held that a contract existed because the parties had acted on the basis that a contract existed. In other words, the acceptance of the offer by the defendant could be inferred from his conduct. A similar result occurred in the case of *Empirnall Holdings Pty Ltd v Machon Paull Partners Pty Ltd* (1988) (NSW) (see below, p 13).

Acceptance must be communicated

Acceptance must be communicated by the offeree, or his or her agent, to the offeror. In *Northern Territory of Australia v Skywest Airlines Pty Ltd* (1987) (NT), the court confirmed that an agent of the offeree may communicate acceptance if duly authorised, or it was reasonable to assume authorisation existed.

Silence as communication

Silence does not constitute acceptance

Silence does not generally constitute acceptance of an offer. In *Felthouse v Bindley* (1862) (CCP), the plaintiff (Felthouse) cabled his nephew stating: 'I will buy your horse for £30 15 s and if I hear no more I will consider it mine.' The nephew never replied and some time later the horse was sold at auction. The plaintiff sued the defendant auctioneer (Bindley) for the tort of conversion. The court held there was no contract between the plaintiff and his nephew and therefore no conversion took place. The nephew (offeree) had never communicated his acceptance and mere 'mental acceptance' was insufficient. In other words, an offeror cannot compel an offeree to take positive steps to reject an offer by stating that silence will amount to acceptance.

Is there any duty to communicate rejection of offer?

There have been circumstances where the court will imply silence as acceptance. In *Empirnall Holdings Pty Ltd v Machon Paull Partners Pty Ltd* (1988) (NSW), there were comprehensive negotiations between the parties concerning a building project. The plaintiff architects (Machon) commenced work on the project and then forwarded to the defendant (Empirnall) a contract and progress payment claim. The plaintiff's covering letter stated that 'we are proceeding on the understanding that the conditions of the contract are accepted by you and works are being conducted in accordance with those terms and conditions'. The defendant, who subsequently acknowledged that the proposed contract was 'fine', paid the claim but never signed the contract. The court, after restating the general rule that silence is not acceptance, held that in some situations there may be a duty on the offeree to communicate a rejection of the offer. The defendant company had such a duty and their acceptance was implied.

Inertia selling prohibited

Legislation now prohibits inertia selling. This is the practice of sending unsolicited goods to a recipient accompanied by a statement that if the goods are not returned within a specified time the recipient will be taken to have agreed to buy them: see (Cth) Trade Practices Act 1974, ss 62A–65 and equivalent State and Territory Fair Trading legislation NSW/NT, ss 57–59; Vic/ACT, ss 28–30; Qld, ss 52–55; SA, ss 71–73; WA, ss 28–31; Tas, s 27.

Postal acceptance rule

The postal acceptance rule is an exception to the principle that the offeree must communicate acceptance to the offeror. Acceptance takes place when the letter of acceptance is posted, not when it is received. In *Adams v Lindsell* (1818) (KB), the defendant (Lindsell) wrote to the plaintiff (Adams) offering to sell him a quantity of wool and requiring acceptance by post, which the plaintiff provided. A problem arose because the defendant's original letter to the plaintiff arrived late because it had been incorrectly addressed. The defendant, believing his offer to have been rejected by the plaintiff, sold the wool to another buyer. This took place after the plaintiff's acceptance had been posted, but before receipt. The court held that the acceptance by the plaintiff was effective on the date of posting, and therefore a binding contract existed between the parties.

The postal acceptance rule also applies to cables (that is, telegrams): see *Cowan v O'Connor* (1888) (QB).

Exceptions to the postal acceptance rule

Intention

For the rule to apply, acceptance by post must have been contemplated by the parties: see *Henthorn v Fraser* (1892) (CA). It may be excluded by the offeror either expressly or impliedly. In *Holwell Securities Ltd v Hughes* (1974) (CA), an option was 'exercisable by notice in writing to the intending vendor within six months from the date of the agreement'. The plaintiff (Holwell) sent a written notice within the prescribed time, but it was never received by the defendant (Hughes). In a subsequent action for specific performance, the court held that the specified requirement for notice in writing to the defendant made the postal acceptance rule inapplicable. In *Nunin Holdings Pty Ltd v Tullamarine Estates Pty Ltd* (1994) (Vic), the court interpreted correspondence between the parties as excluding the operation of the postal acceptance rule.

Revocation

The rule does not apply to revocation by post. In *Byrne and Co v Leon Van Tienhoven and Co* (1880) (CCP), the plaintiff (Van Tienhoven) posted a letter to the defendant (Byrne) offering to sell tinplate. The plaintiff posted a further letter a week later revoking the offer. Unfortunately for the plaintiff, it was not received until after the

defendant had cabled its acceptance. The court held that the postal acceptance rule is 'inapplicable to the case of a withdrawal of an offer' even though the letter of revocation was posted before the acceptance cable was sent.

Instantaneous communication

The rule does not apply to means of instantaneous communication such as telex, telephone, facsimile transmission or electronic mail. In *Entores Ltd v Miles Far East Corporation* (1955) (CA), the plaintiff (Entores) carried on business in London, and the defendant (Miles) carried on business in Amsterdam (through an agent). Both parties had a telex machine. The plaintiff telexed offering to buy goods from the defendant. The defendant's agent accepted this offer by return telex. The court held the postal rule does not apply to 'virtually instantaneous' communications. Therefore, the agreement arose upon receipt of the acceptance (that is, in London). This approach was followed in *Brinkibon Ltd v Stahag Stahl GmbH* (1983) (HL), where Lord Wilberforce stated that the question of where an acceptance takes place will often be a complex one and will have 'to be resolved by reference to the intentions of the parties, by sound business practice, and in some cases by a judgment where the risks will lie'. It is presumed that facsimile transmission and email are forms of instantaneous communication, although the rule may still apply if the acceptance is transmitted by a public provider (for example, Australia Post). In *Leach Nominees Pty Ltd v Walter Wright Pty Ltd* (1986) (WA), the court held that the postal acceptance rule applied to an acceptance sent by 'public telex'.

Certainty of terms and incomplete agreements

Intentions must be clear

For a valid agreement to exist, the parties must make their intentions clear. This depends upon the intention disclosed by the language the parties have employed. In *Masters v Cameron* (1954) (HC), the defendant (Cameron) owned a farm and his agent entered into a contract for sale with the plaintiff (Masters). The agreement was 'subject to the preparation of a formal contract of sale which shall be acceptable to [the defendant's] solicitors'. The purchaser subsequently decided not to continue and the plaintiff unsuccessfully sued. The court held that there was no binding contract. The court noted that, where negotiating parties reach agreement upon contractual terms but

make their agreement dependent upon formal documentation, the agreement may be in one of three categories:

- where the parties have reached finality (and intend no departure) and merely wish to reflect their agreement in a fuller and more precise form. In this situation, there is a binding contract;
- where the parties have reached finality (and intend no departure) but have made performance of one or more of the terms conditional upon the execution of a formal document. In this situation, there is a binding contract;
- where the intention of the parties is not to make a concluded bargain at all until they execute a formal contract. In this situation, there is no binding contract, as was held in *Masters v Cameron* (1954) (HC).

It is worth noting that the High Court had previously referred to a further category in *Sinclair, Scott and Co v Naughton* (1929) (HC), namely: ‘... one in which the parties were content to be bound immediately and exclusively by the terms which they had agreed upon, whilst expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms.’ This further category (that is arguably a variation on the first category) was also discussed in *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) (NSW) and *Brunninghausen v Glavanics* (1999) (NSW).

Vague language and omissions

A court may decide that a contract is void for uncertainty, either because the language of the agreement is too vague or the contract omits an important aspect of the agreement. Generally, the courts will try to uphold contracts by giving a reasonable interpretation to the words used in them (see *Upper Hunter County District Council v Australian Chilling and Freezing Co Ltd* (1968) (HC)) or by imposing a standard of good business practice (see *Trustees Executors and Agency Co Ltd v Peters* (1960) (HC)).

3 Intention

You should be familiar with the following areas:

- presumptions associated with intention to be legally bound
- statutory modifications relating to contractual intention

An intention to be legally bound is the second essential element of contract formation. A contract does not come into existence unless the parties intend to enter into a legal relationship and be legally bound by it. Intention may be expressed by the parties or implied by their conduct. In relation to implied intention, the courts have developed the following rebuttable presumptions:

- (a) parties to contracts involving domestic, social and family matters do not intend legal enforceability;
- (b) parties to contracts involving commercial and business matters do intend legal enforceability.

Domestic, social and family agreements

Husbands and wives

In *Balfour v Balfour* (1919) (CA), the husband agreed to pay his wife monthly support until she rejoined him in Sri Lanka. The reunion did not eventuate and the husband failed to honour the agreement. The wife sued for breach of contract but was unsuccessful. The court held that, in the absence of an express intention, the presumption was clearly against enforceability. Their agreement involved matters of a social or domestic nature and there were no facts to rebut the presumption that applies. A similar result occurred in *Cohen v Cohen* (1929) (HC). These agreements are now covered by statute, in particular the (Cth) Family Law Act 1975 as well as the State and Territory *de facto* relationships legislation.

Other family members

In *Jones v Padavatton* (1969) (CA), the court held that a contract made between a mother and her daughter was void for lack of evidence that the parties intended to be bound. In other words, the presumption that the parties did not intend to be bound by the contract was not rebutted. By contrast, in *Wakeling v Ripley* (1951) (NSW), the defendant (Wakeling) wrote to his sister (Ripley) in England and asked her and her husband to move to Sydney and care for him, and in return he would leave his house to them in his will. The plaintiffs left their employment in England, sold their home, came to Australia, and cared for the defendant for several months. Following an argument, the defendant sold his house and changed his will. The plaintiffs successfully sued for breach of contract. The court held that, on the evidence, the parties intended to enter into a legal relationship and therefore the presumption had been rebutted. A similar result occurred in *Riches v Hogben* (1986) (Qld) which involved a contract between a mother and son. The court stated that it must examine all the surrounding facts and determine objectively whether the contract was intended to be binding.

Rebuttal of presumption

The presumption may be rebutted by evidence of the real intention of the parties. The following factors are relevant:

- (a) what the parties said to each other either orally or in writing;
- (b) the context in which the statements were made;
- (c) the conduct of the parties;
- (d) how grave the consequences would be to the innocent party if the promises made by the other party were to be breached.

Commercial and business agreements

Presumption of intention

In *Carlill v Carbolic Smoke Ball Co* (1893) (CA) (see Chapter 2, p 6), the court held that the presumption of intention applied despite the defendant's argument that the advertisement was a 'mere puff' or, alternatively, a 'promise in honour only'.

Onus of proof

The presumption of intention may be rebutted but the onus of proof rests with the party seeking to exclude the presumption. In *Australian Woollen Mills Ltd v Commonwealth of Australia* (1954) (HC), the defendant (the Australian Government) granted a subsidy to certain manufacturers, including the plaintiff (Woollen Mills), who purchased Australian wool for local manufacture. Some years later, the defendant discontinued the subsidy. In subsequent proceedings, the plaintiff argued that the subsidy arrangement between the parties was a commercial agreement and that there was a presumption of intention. The court held that the presumption had been rebutted and that no intention to create legal relations existed. The presumption was also rebutted in *ABC v XIVth Commonwealth Games Ltd* (1988) (NSW).

Express statements

Parties to a commercial or business agreement may expressly declare that their agreement is not to be binding in law. In *Rose and Frank Co v JR Crompton and Bros Ltd* (1925) (HL), the court saw no public policy reason why it should not give effect to an express intention not to form a legal relationship. Nevertheless, the words used in the contract must be clear and unambiguous. In *Edwards v Skyways Ltd* (1964) (QB), the words ‘*ex gratia*’ were used to describe the promise of a redundancy payment. The court held that these words were insufficient to negative contractual intention. The court construed the words as a non-admission of liability by the defendant to make a redundancy payment. By contrast, in *Jones v Vernon’s Pools Ltd* (1938) (KB), the court held that a clause included in a soccer pools coupon was effective to prevent any action being taken against the defendant in a court of law.

Statutory modifications

Even though the common law may find that no contract was formed because of lack of legal intention, a remedy may still arise under statute, in particular, (Cth) Trade Practices Act 1974 and State and Territory Fair Trading legislation:

- (a) s 52 (misleading and deceptive conduct); NSW/NT, s 42; Vic, s 11; Qld, s 38; SA, s 56; WA, s 10; Tas, s 14; ACT, s 12;
- (b) s 53 (false and misleading representations); NSW/NT, s 44; Vic, s 12; Qld, s 40; SA, s 58; WA, s 12; Tas, s 16; ACT, s 14.

4 Consideration

You should be familiar with the following areas:

- formal and simple contracts
- what constitutes valid consideration
- kinds of consideration
- promissory estoppel and its development

Consideration is the third essential element of contract formation. However, consideration is only required to form a simple contract.

Formal and simple contracts

Formal contract

A formal contract is wholly in writing, usually in the form of a deed, and does not require consideration. A promise (or term) of a contract made by deed is called a covenant. A deed can be unilateral (that is, made by only one party) and this is often called a deed poll. A deed made by two or more parties is called an indenture. Some types of contracts must be in writing and must be made by deed to be effective (for example, a conveyance of non-Torrens title land).

Simple contract

A simple contract may be oral or in writing (or a combination of both). Simple contracts are made between two or more parties and require consideration.

Defining ‘consideration’

Sir Frederick Pollock defined consideration as ‘an act of forbearance of one party or the promise thereof, is the price for which the promise of

the other is brought and the promise thus given for value is enforceable' (Pollock's *The Principles of Contracts*). This definition was adopted in *Dunlop Pneumatic Tyre Co Ltd v Selfridge Co Ltd* (1915) (HL). In other words, consideration is simply something of value and may take the form of:

- (a) an act for a promise;
- (b) a promise for an act;
- (c) a promise for a promise;
- (d) a promise to forbear (that is, not to do something).

Rules for consideration

Consideration must be present in every simple contract

In *Rann v Hughes* (1778) (KB), the defendant (Hughes) was administrator of an estate and made a promise to pay a debt owed by the deceased to the plaintiff (Rann). The court held that, as there was no consideration given by the plaintiff for the promise made by the defendant, the contract was void.

Consideration must move from the promisee

Only the promisee can enforce the promise

Apart from the promisor, the only party who can enforce the contract is the other party who has provided the consideration for the promise. In *Dunlop Pneumatic Tyre Co Ltd v Selfridge and Co Ltd* (1915) (HL), the plaintiff (Dunlop) entered into a contract to sell tyres to a dealer (Dew and Co). The contract provided that the dealer would not sell tyres below the plaintiff's list price and would obtain a similar undertaking from any retailer they onsold to. The dealer subsequently sold tyres to the defendant (Selfridge) who gave the required undertaking. The defendant later sold tyres to a customer below the plaintiff's list price and the plaintiff sued for breach of the undertaking. The court found for the defendant. The plaintiff had not provided any consideration for the defendant's promise to the dealer. The plaintiff was not even a party to that subsequent contract.

Joint promisees

This rule is satisfied if consideration moves from one (or only some of) joint promisees: see *Coulls v Bagot's Executor and Trustee Co Ltd* (1967) (HC), discussed in Chapter 7.

Consideration may move to a third party

This rule does not require that the promisor must receive the benefit of the consideration provided by the promisee. In other words, consideration need not move to the promisor, but can be provided to a third party.

Consideration must be sufficient, but need not be adequate

Objectively, if consideration of some value exists, the court is not concerned with its adequacy. In *Thomas v Thomas* (1842) (QB), the court held that a promise by a widow to pay an annual rent of £1 was sufficient consideration for a contract with the executors to transfer a life estate in the property to her. In *Chappell and Co v Nestlé and Co Ltd* (1960) (HL), the plaintiff (Chappell) owed the copyright in a song 'Rockin' Shoes' and the defendant (Nestlé) made chocolate bars. In an attempt to increase sales, the defendant offered to 'sell' several popular records (including the one owned by the plaintiff) for the price of 1 s 6 d and three (6 d) chocolate bar wrappers. The law at that time required the defendant to pay the plaintiff a royalty of 6.5% of the ordinary resale selling price of the record. The defendant offered to pay the plaintiff the applicable royalty based on the cash price received (that is, 1 s 6 d). The plaintiff sought a royalty based upon the cash price received plus the cost of the three chocolate bars (that is, 3 s 0 d). A majority of the court agreed with the plaintiff and held that the chocolate bar wrappers constituted part of the consideration for the purchased record. It was irrelevant that the defendant discarded the chocolate bar wrappers after receiving them.

Consideration must be definite and not illusory

The consideration must be so certain that a court is able to place a legal value on it, no matter how inadequate it may actually be. In *White v Bluett* (1853) (Ex), the defendant (Bluett) promised 'not to bore his father' in return for non-payment of a debt. Following the father's death, the plaintiff executor (White) sought repayment of the debt due by the defendant. The defendant relied on his agreement with his late

father as a defence to the claim. The court found for the plaintiff and held that the son's promise was too vague to have a legally recognised value. In *Placer Development Ltd v Commonwealth* (1969) (HC), the plaintiff (Placer) entered into a contract with the defendant (the Australian Government) to establish a timber company in Papua New Guinea to produce plywood for import to Australia. A clause in the agreement stated that the defendant would subsidise (at a rate to be determined only by the defendant) the cost of import customs duty into Australia. The subsidy was paid for some years and then later withdrawn. The High Court (by a 3:2 majority) held that the clause was not binding on the defendant. The majority noted the illusory nature of the promise made by the defendant. Kitto J stated that 'a promise of a governmental subsidy is meaningless in the absence of some amount or some basis of calculation'.

Consideration must be lawful

The consideration must not be illegal or unlawful and must not involve a breach of civil law or public policy. In *Parkinson v College of Ambulance Ltd and Harrison* (1925) (KB), the plaintiff (Parkinson) gave the defendant charity (College) £3,000 in return for a promise that he would receive a knighthood. The knighthood did not eventuate and the plaintiff sued for the return of the money. The court refused to make the order. The consideration was a promise to do something to promote public corruption and this was illegal as it was against public policy (discussed further in Chapter 11).

Kinds of consideration

Executory

Consideration is executory when one party makes a promise in return for a counter-promise by the other party. In other words, it is a promise to do something in the future (for example, the promise by the Carbolic Smoke Ball Co to pay '£100 reward').

Executed

Consideration is executed once the promise has been performed in full (for example, Mrs Carlill buying and using the carbolic smoke ball).

Past consideration

Consideration can be present or future, but not past. In *Roscorla v Thomas* (1842) (QB), the plaintiff (Roscorla) purchased a horse from the defendant (Thomas). After the sale had been concluded, the defendant promised the plaintiff that the horse was in good health and not vicious. The horse was vicious and the plaintiff sued for breach. The court held the promise was not binding as it was made independently of the sale (that is, after the sale). The defendant's subsequent promise was not supported by a return promise from the plaintiff, and therefore it could not be enforced.

Exceptions to the past consideration rule

Common law exceptions

There have been a number of cases where the court appears to have developed an exception to the past consideration rule. In *Lampleigh v Brathwait* (1615) (KB), the defendant (Brathwait), who had committed murder, asked the plaintiff (Lampleigh) to obtain a pardon for him from the King. The plaintiff agreed and in the process incurred considerable expense. Subsequently, the defendant promised to the plaintiff £100 to cover costs. The defendant failed to make the payment and the plaintiff sued. The defendant argued that the subsequent promise was unsupported by consideration. The court disagreed and held that the defendant's request for assistance included an implied promise that the plaintiff would ultimately be paid for his services. In other words, the request for assistance and the promise to pay £100 were part of the same transaction. It is arguable that, where past services are rendered at the request of the promisor, then a subsequent promise to pay is enforceable. Similarly, in *Re Casey's Patents: Stewart v Casey* (1892) (CA), the court held that a subsequent promise to pay may be treated either as an admission of the act (that is, service) provided or as evidence that the parties subsequently fixed the amount of reasonable remuneration for the act. In *Pao On v Lau Yiu Long* (1980) (PC), Lord Scarman noted the following requirements for the exception to apply:

- (a) the act must have taken place at the promisor's request;
- (b) objectively, the parties must have understood that the act was to be remunerated or compensated;
- (c) the remuneration or compensation must have been legally enforceable.

Statutory exceptions

There are some statutory exceptions to the past consideration rule:

- (a) bills of exchange: s 32 of the (Cth) Bills of Exchange Act 1909 provides that 'valuable consideration for a bill may be constituted by ... an antecedent debt or liability';
- (b) subsequent acknowledgment of a debt: under the Limitation Acts in NSW (s 54), Victoria (s 24), Queensland (s 35) and Tasmania (s 29), a cause of action is deemed to have accrued on and not before the date of the acknowledgment or last payment. In other words, the subsequent promise to pay an existing debt (even if unsupported by consideration) 'revives' a cause of action so that the limitation period commences to run from the time of the acknowledgment.

Promises to perform an existing obligation

The general rule is that a promise to perform an existing contractual duty is not good consideration. In *Stilk v Myrick* (1809) (KB), the plaintiff (Stilk) signed on as a crew member on a ship. During the voyage, two crew members deserted and the defendant captain (Myrick) promised to divide the wages that would have been paid to the deserters among the remaining crew. When the defendant failed to honour his promise the plaintiff sued. The court held there was no consideration for the promise to pay the extra wages. Under the original agreement, the plaintiff and the other crew members contractually promised 'to do all they could under all emergencies of the voyage'. The desertion of two crew members was an emergency and therefore the plaintiff was already under a contractual duty to help bring the ship back. A different conclusion was reached in *Hartley v Ponsonby* (1857) (KB). In this case, the defendant captain (Ponsonby) promised the plaintiff (Hartley) an additional payment if he helped sail the ship back to its home port. The plaintiff agreed and the defendant later reneged on his promise. Unlike the previous case, nearly half the 36 crew members had deserted the ship when it was docked en route. The court held that the plaintiff had done more than he was contractually bound to do and therefore provided consideration.

Factual benefit

In *Williams v Roffey Bros and Nicholls (Contractors) Ltd* (1991) (CA), the court held that the general rule will not apply if the promisor receives factual benefits from the performance of the existing obligation. Likewise, the court stated that the general rule will not apply if the promisor avoids a 'disbenefit' that might have resulted from the promisee's failure to perform an existing obligation. This view was supported in *Musumeci v Winadell Pty Ltd* (1994) (NSW).

Public obligations

A duty imposed by the State will not amount to consideration unless it involves an excess of legal duty. In *Collins v Godefroy* (1831) (KB), the defendant (Godefroy) subpoenaed the plaintiff (Collins) to give evidence in court and promised to pay him for his attendance. The plaintiff attended court but did not have to give evidence. The defendant later refused to pay the promised amount. The court held that a person who receives a subpoena is under a legal duty to give evidence. In *Glasbrook Bros v Glamorgan CC* (1925) (HL), the defendant colliery owners (Glasbrook) requested the defendant (Glamorgan) to station a police guard in the colliery premises to protect non-union workers during a strike. The police believed that mobile foot patrols would provide adequate protection and only agreed to the defendant's request when they agreed to pay the police the extra costs associated with the increased protection. When the strike was over, the defendant refused to pay, arguing that the police had not provided consideration because it was their public duty to protect property. The court disagreed and held that the police had done more than they considered necessary for the adequate protection of the colliery.

Third party obligations

A promise to perform an existing obligation is sufficient consideration where the promise is made to a different person. In *Shadwell v Shadwell* (1860) (CCP), the plaintiff wrote to his uncle informing of his engagement to marry. His uncle then promised to make certain payments to the plaintiff once the marriage took place. The plaintiff subsequently married and his uncle made some, but not all, of the agreed payments. When the uncle died, the plaintiff sued the estate to recover the outstanding payments. The defendant (estate) argued there was no consideration for the promise because the plaintiff had previously promised to marry his now wife. The court held that a

contract to do something which the promisor is under an existing obligation to a third party to do (that is, marry his fiancée) can be good consideration. The late uncle obtained a real benefit (that is, having his nephew marry) and the plaintiff had materially altered his position. This view was confirmed in *New Zealand Shipping Co Ltd v AM Satterthwaite and Co Ltd (The Eurymedon)* (1975) (PC).

Part payment of a debt

The general rule is that payment of a lesser sum will not discharge the duty to pay a higher sum: see *Pinnel's* case (1602) (CCP). In other words, part payment of a debt is not sufficient consideration for a promise to forgo the balance. The rule was confirmed in *Foakes v Beer* (1884) (HL), where the defendant (Foakes) owed the plaintiff (Beer) £2,090. The plaintiff subsequently agreed to allow the defendant to pay off the debt by an immediate payment of £500 and the balance by instalments, and in return she gave a promise not to commence debt recovery proceedings against the defendant. The defendant made all the instalment payments as agreed. The plaintiff later demanded an additional £360 as interest on the debt and the defendant refused to pay. The court held that the interest was payable. The defendant had a pre-existing obligation to pay the whole debt and the mere payment by instalments of the debt was not sufficient consideration.

The following are exceptions to the rule in *Pinnel's* case:

Different promise

An exception arises where the creditor agrees to something different from that originally promised (for example, where payment is made at an earlier time, at a different place, or by a different method). The court will examine these differences objectively. In *D and C Builders Ltd v Rees* (1965) (CA), the court rejected an argument that part payment by cheque (as distinct from cash) constituted payment by a different method.

Third party promise

A further exception arises where a lesser sum is paid by a third party to discharge the creditor's debt. In *Hirachand Punamchand v Temple* (1911) (CA), the plaintiff (Hirachand) lent money to the defendant (Temple). When the defendant could not repay the loan, his father agreed with the plaintiff to pay a lesser amount in full settlement. The defendant's father paid and the plaintiff then sued for the balance. The court held the debt owed by the defendant had been extinguished and

stated that 'it would be fraud upon a stranger who pays part of a debt in discharge of the whole, that an action should be brought for the debt'.

Promissory estoppel

The equitable doctrine of promissory estoppel (discussed below, p 30) may, under certain circumstances, allow part payment in full satisfaction of a debt due.

Bankruptcy

Another exception arises where a part payment promise is made by a debtor under a composition agreement with creditors under the (Cth) Bankruptcy Act 1966, or if a company, under the national Corporations Law.

Consideration may be a promise not to sue

Consideration may consist of a promise to refrain from taking legal action. In *Hercules Motors Pty Ltd v Schubert* (1953) (NSW), the plaintiff (Schubert) purchased a car from the defendant (Hercules). The plaintiff later found that the car had faulty paintwork and initially demanded a new car. In response, the defendant agreed to repaint the car and put it into an 'as new' condition. The parties also agreed for a representative of a paint company to supervise the work and report on it. The report was unsatisfactory and the plaintiff sued the defendants for failing to put the car into an 'as new' condition. By way of defence, it was argued that there was no consideration given by the plaintiff for the defendant's promise. The court held that there was a genuine dispute between the parties as to their respective rights and obligations and that the agreement to repaint was a compromise of that dispute. The plaintiff's compromise was good consideration for the defendant's 'as new' promise, even though he may not have had an enforceable claim against the defendant at the time. In other words, if the promisee has a *bona fide* belief that there is a fair chance of success and the claim is reasonable, then giving up that claim provides sufficient consideration for a promise. Similarly, in *Wigan v Edwards* (1973) (HC), the plaintiffs (Edwards) signed a contract to purchase a house from the defendant (Wigan) who was an owner-builder. Subsequently, the plaintiffs discovered several defects that they told the defendant required fixing before they would consider going ahead with the purchase. The defendant gave the plaintiffs a written promise to fix the defects and the contract was completed. The defendant failed to fix the defects and the plaintiffs sued for breach of the promise. The

court held that the defendant had breached his promise and accordingly the plaintiffs were entitled to damages. The court found that there was consideration in the compromise by the plaintiffs of their claim.

Promissory estoppel

Given the strictness of the requirement of consideration, there has been a gradual movement by the courts to a greater protection of the weaker party to the agreement. The courts have begun to place more emphasis on the circumstances (generally detrimental) of reliance on a promise. The key feature of the estoppel is unconscionability. In other words, a promisor is estopped from denying a promise if it is unconscionable to depart from the assumption that the promisee has made in reliance on the promise.

Promissory estoppel in a pre-existing legal relationship

***High Trees* estoppel**

Traditionally the courts have made a distinction between common law estoppel (that is, representations of existing facts) and equitable promissory estoppel (that is, representations of future intention). In *Central London Property Trust v High Trees House Ltd* (1947) (CA), the plaintiff (Central) leased a block of flats to the defendant (High Trees) in 1939 for 99 years at an annual rental of £2,500. The outbreak of the war made it difficult for the defendant to find enough tenants and therefore pay the rent due to the plaintiff. Consequently, in early 1940, the plaintiff agreed to reduce the rent by 50% (but failed to stipulate the period that the reduced rent would apply). The defendant paid the reduced rent for five years. In early 1945, the flats began to fill again, and by mid-1945 the flats were full. The plaintiff (in a test case) then successfully sued the defendant for £625, being the difference due in the agreed rent for the last six months of 1945 (that is, from the time the flats were fully occupied). The court held that the 1940 agreement was only valid for the duration of the war and therefore the plaintiff was entitled to the originally agreed rent. However, in *obiter*, Lord Denning stated that, had the plaintiff sued for the arrears in rent for the period 1940–1945, it would have failed. The 1940 agreement would act as an estoppel (that is, as a defence) to any claim for arrears, notwithstanding that the defendant had not provided any consideration for the plaintiff's promise to accept the lower rent.

Promissory estoppel as a 'shield'

Historically, the doctrine was a rule of evidence and could only be used as 'a shield and not a sword'. In other words, the doctrine could never do away with the requirement of consideration. In *Combe v Combe* (1951) (CA), the defendant (husband), in the course of divorce proceedings, promised the plaintiff (wife) that he would pay her a yearly allowance of £100. The plaintiff did not apply for spousal support following the divorce because it appears that such an order would not have been likely because her income exceeded that of the defendant. The defendant made only one payment of £25. The plaintiff later sued him for £675 (being the arrears due at that time). The trial judge found that although there was no consideration for the defendant's promise, it was nonetheless enforceable due to the doctrine of promissory estoppel. This decision was overturned on appeal. Lord Denning stated that the doctrine 'does not create new causes of action where none existed before ... it only prevents a party from insisting upon his strict legal rights'.

Detriment factor

The doctrine only applies if it is inequitable to allow a promisor to resile from a promise. In other words, detriment is a necessary element of promissory estoppel. In *Je Maintiendrai Pty Ltd v Quaglia* (1980) (SA), the defendant (Quaglia) leased a shop in a shopping centre owned by the plaintiff (Je Maintiendrai). As many of the other shops in the centre were empty, the plaintiff, as an inducement to keep the defendant as a tenant, agreed to reduce the rent payable. The defendant paid this reduced rent for 18 months. When the plaintiff learnt that the defendant was about to vacate, it unsuccessfully sued for the 'arrears of rent'. The court held that for the doctrine of promissory estoppel to apply, the element of detriment had to be established. The court found that as the 'arrears of rent' would have to be paid in a lump sum, this was a sufficient detriment to the defendant.

Promissory estoppel is part of Australian law

The High Court finally considered the doctrine of promissory estoppel in *Legione v Hateley* (1983) (HC). The plaintiff (Hateley) entered into a standard agreement to purchase land from the defendant (Legione). As the plaintiff was unable to settle the purchase by the due date, the defendant served a 'notice to complete' which was to expire on 10 August 1979. On 9 August 1979, the purchaser's solicitor rang the vendor's solicitor and spoke to an employee (Williams), the secretary of one of the partners of that firm. The purchaser's solicitor advised

that his clients were getting bridging finance and that they would be able to settle on 17 August 1979. According to the evidence, the secretary replied: 'I think that'll be alright, but I'll have to get instructions.' On 14 August 1979, the purchaser's solicitor received a notice of rescission. The court, after finding that the doctrine was part of Australian law, held that the secretary's statement did not raise an estoppel in favour of the plaintiff. Mason and Deane JJ stated that for the doctrine to apply, the promise must be clear and unequivocal, and the promisee must have 'placed himself in a position of material disadvantage if departure from the assumptions be permitted' (using the words of Dixon J in *Thompson v Palmer* (1933) (HC)).

Promissory estoppel where there is no pre-existing legal relationship

Promissory estoppel 'as a sword'

In Australia, promissory estoppel can now be used to commence an action, in addition to defending one. In *Waltons Stores (Interstate) Ltd v Maher* (1988) (HC), the plaintiff (Maher) owned a commercial property that the defendant (Waltons) commenced negotiations to lease. As part of their agreement, the plaintiff was to construct a building according to the defendant's plans and specifications. An existing building had to be demolished before construction of the new store could commence. On 21 October 1983, a draft agreement for lease was sent to the plaintiff's solicitors, who subsequently requested amendments. On 7 November 1983, the plaintiff's solicitors informed the defendant's solicitors that the plaintiff needed the agreement signed, otherwise they could not build the new store within the time required. In addition, they also indicated that the plaintiff did not want to demolish the existing building until it was clear that there were no problems with the proposed agreement. Later that day, the defendant's solicitors forwarded a new agreement incorporating the requested amendments with a letter stating: 'we have not yet obtained our client's specific instructions to each amendment requested but we believe approval will be forthcoming ... we shall let you know tomorrow if any amendments are not agreed to.' The agreement was signed by the plaintiff and returned to the defendant's solicitors 'by way of exchange' on 11 November 1983. As they heard nothing further, the plaintiff commenced work by demolishing the existing building (a fact known to the defendant by 10 December). The

defendants, having changed their commercial plans, instructed their solicitors to 'go slow' and chose not to execute the agreement. In early January, the plaintiff commenced building the new premises. On 19 January 1984 (with about 40% of the new building completed), the defendant finally informed the plaintiff that they would not be proceeding with the agreement. The plaintiff subsequently sought, *inter alia*, a declaration that a binding agreement existed. At first instance, Kearney J held the defendant was estopped from denying the existence of an agreement with the plaintiff. This decision was confirmed by both the NSW Court of Appeal and the High Court. The trial judge and the NSW Court of Appeal found that a common law estoppel existed (rather than promissory estoppel) because the defendant had misrepresented an existing state of facts (that is, that a contract existed between the parties). By contrast, a majority of the High Court found for the plaintiff on the basis of a promissory estoppel (that is, that an exchange of contracts would take place). More significant was the High Court's pronouncement that promissory estoppel now applied to pre-contractual statements as to future intention. In other words, the doctrine can apply even where there is no pre-existing contractual relationship between the parties.

Unconscionability and detriment

In *Waltons Stores*, the High Court also reiterated the requirement that the promisor must have acted unconscionably and to the detriment of the party relying on the promise. The requirement of detriment was further confirmed in *Commonwealth of Australia v Verwayen* (1990) (HC).

Commercial transactions

The doctrine is unlikely to apply in larger commercial transactions. In *Austotel Pty Ltd v Franklins Selfserve Pty Ltd* (1989) (NSW), the court noted that the parties were large commercial entities with equal bargaining power (unlike the plaintiff in *Waltons Stores*). The court rejected the plaintiff's (Franklins) argument that promissory estoppel applied and concluded that the plaintiff had acted in reliance on its own commercial interests rather than on any promises made by the defendant (Austotel).

5 Writing

You should be familiar with the following areas:

- contracts that must be deeds
- contracts that must be reduced to writing
- contracts that must be evidenced in writing
- the doctrine of part performance

Writing is not an essential element of simple contract formation unless it is required by statute. At common law, a contract can be wholly oral, partly oral and partly written, or wholly written. There are legislative exceptions to this general rule and some contracts are required to be either:

- (a) made by deed (that is, a formal contract 'under seal');
- (b) totally in writing;
- (c) evidenced in writing.

Contracts that must be made by deed

Examples of contracts that must be made by deed include:

- (a) gratuitous promises (that is, promises unsupported by any consideration and intended to be binding) (refer to Chapter 4);
- (b) a conveyance (or lease for a period exceeding three years) of real property;
- (c) appointment of an agent whose authority includes contracting by deed on behalf of the principal;
- (d) contracts made by non-trading corporations must be made by seal (except in Victoria or if incorporated under the Corporations Law) unless the contract is of frequent occurrence or trifling importance.

Historically, a deed had to be written or printed on paper, the names of the parties had to appear on it, and it had to be sealed and delivered. State and Territory legislation now provides that a deed must be signed by the party executing it, and attested to by a witness who is not party to it: for example, see s 38 of the (NSW) Conveyancing Act 1919. Intention to seal and to deliver (that is, as expressed in the deed) is now sufficient.

Contracts that must be reduced to writing

Examples of contracts that must be reduced to writing include:

- (a) bills of exchange: see (Cth) Bills of Exchange Act 1909, ss 8, 78 and 89;
- (b) cheques and promissory notes: see (Cth) Cheques and Payments Orders Act 1986, ss 10 and 101;
- (c) contracts of marine insurance: see (Cth) Marine Insurance Act 1909, s 28;
- (d) transfers of shares in a company: see Corporations Law, s 1091.

Non-compliance will render the contract either void or unenforceable.

Contracts that must at least be evidenced in writing

(UK) Statute of Frauds 1677

Historically, the requirement of writing was introduced to make fraud more difficult to commit: see (UK) Statute of Frauds 1677. While the old imperial statute became part of Australian law by virtue of the doctrine of reception, its current application is not uniform throughout the various States and Territories (see below, p 37). Examples of contracts covered by s 4 of the old statute included:

- (a) 'any special promise' by an executor to satisfy the liability of the deceased 'out of his own estate' (that is, the executor's own funds);
- (b) 'any special promise to answer for the debt, default or miscarriages of another person';
- (c) agreements 'made upon consideration of marriage';

- (d) agreements for the 'sale of land, tenements or hereditaments';
- (e) agreements 'not to be performed within the space of one year from the making thereof'.

The old statute provides that unless the writing formalities are complied with, 'no action shall be brought' to enforce the agreements referred to. In other words, at common law, such contracts are unenforceable, but not void. Consequently, a third party transferee of an interest in the subject matter of the original agreement can obtain a good title to that interest, notwithstanding the unenforceability by either party of the original agreement. Even though a contract may be unenforceable at common law, equity may be prepared to order specific performance if the promisee can demonstrate that, in reliance on the promise, partial performance has taken place (see below, p 39).

Section 4 of the old statute is no longer in force in NSW, Queensland, South Australia and the ACT; and in Victoria, Western Australia and Tasmania, the important aspects of the section have been replaced. The old statute has survived in the Northern Territory.

Dispositions of land

In all Australian jurisdictions, the requirement that contracts for the sale, lease or other disposition of land be evidenced in writing has been retained:

- (a) (NSW) Conveyancing Act 1919, s 54A;
- (b) (Vic) Instruments Act 1958, s 56;
- (c) (Qld) Property Law Act 1974, s 59;
- (d) (SA) Law of Property Act 1936, s 26(1);
- (e) (WA) Property Law Act 1969, s 34(1);
- (f) (Tas) Conveyancing and Law of Property Act 1884, s 36(1);
- (g) (ACT) Imperial Acts (Substituted Provisions) Act 1986, s 3 (Sched 2, Pt 11, cl 4);
- (h) (NT) Statute of Frauds 1677, s 4.

In *Riches v Hogben* (1986) (Qld) (discussed in Chapter 3), the defendant (Hogben) argued that she had no written contract (or a contract evidenced in writing) with her plaintiff son (Riches) to transfer real property to him. The court agreed and held that this agreement was unenforceable by virtue of the relevant Queensland statute.

Contents of the document

The document evidencing the contract between the parties must contain all the essential terms. These include the so called '3 Ps' – parties, property and price.

Parties (identification of parties)

In *Rosner v Austral Wine and Spirit Co Pty Ltd* (1980) (Vic), the court held that this requirement is met 'if the description [of the parties used in the document] can be explained by extrinsic evidence without having to resort to evidence to prove the intention of the author'. In other words, an objective test applies.

Property (sufficient description of subject matter)

In *Pirie v Saunders* (1961) (HC), the document referred to sale of 'part of Lot B, Princes Highway, Sylvania Heights', but contained no additional description like a street, and more importantly, no Torrens title references (for example, a lot in deposited plan). The court found that the description was not sufficient for the purposes of the NSW statute.

Price (stating consideration accurately)

In *Ram Narayan v Rishad Hussain Shah* (1979) (PC), the court held that the failure to apportion the consideration between the land and the chattels sold rendered the agreement insufficient for the purposes of s 4 of the (UK) Statute of Frauds.

Document must be signed

The document evidencing the agreement between the parties must contain the signature of the person being sued (or authorised agent). Courts have given this a loose interpretation. In *Thomson v McInnes* (1911) (HC), Griffiths CJ stated that the Statute of Frauds contemplated 'three different modes of signature':

- (a) 'a person with his own hand';
- (b) 'an amanuensis [that is, a clerk or secretary who writes from dictation] signing the name of another person in that other person's presence by his direction';
- (c) 'an agent'.

The signature, in whatever form it appears, must constitute an acknowledgment by the party being sued (or authorised agent) that a contract has been entered into.

Contract may consist of more than one document

A contract will comply with the writing requirement if it consists of several documents, provided they are connected, and when connected, they form a complete agreement. The connecting document may be identified by oral evidence (see *Harvey v Edwards Dunlop and Co Ltd* (1927) (HC)).

Any variation must be evidenced in writing

If a writing requirement applies, any contractual variation must also be evidenced in writing because the writing must contain all the terms. If the variation is purely oral it cannot (subject to the doctrine of part performance, below) be enforced, and the original contract remains binding. In *British and Beningtons Ltd v North Western Cachar Tea Co Ltd* (1923) (HL), several contracts for the sale of tea required delivery to be made in London, but due to port congestion, the ship carrying the tea was diverted to another port outside London. The defendant (North) alleged that the plaintiff (British) orally agreed to a delivery outside London in return for a price reduction. The court held that the variation was not enforceable because the Sale of Goods legislation required the contract to be evidenced in writing. Accordingly the contract was enforceable in its original, unaltered form.

Part performance

The equitable doctrine of part performance may overcome the strict application of the writing requirement. Four conditions must be met:

- (a) the acts constituting the part performance must be referable to the alleged agreement and be explicable for no other reason. In *Regent v Millett* (1976) (HC), the purchasers successfully argued that various acts (that is, taking possession of the land, making mortgage payments, and effecting repairs, renovations and additions to the property) constituted part performance under an oral contract for the sale of the land;

- (b) the acts must be such as to render it unconscionable to allow a party to rely on the Statute of Frauds;
- (c) the acts relate to a contract which would be enforceable by equity (for example, the court can award specific performance);
- (d) there must be adequate oral evidence that a contract existed between the parties.

6 Contents

You should be familiar with the following areas:

- whether a statement is intended to be a mere representation or a term
- the parol evidence rule
- implied terms
- collateral contracts
- whether a term is a condition, warranty or intermediate term, and its implications
- exclusion clauses
- alternative dispute resolution clauses

Once the existence of a contract has been confirmed, it becomes necessary to examine its contents to identify and understand the obligations and rights of each contracting party. This involves a two stage process to determine:

- (a) what are the terms of the contract;
- (b) what is the meaning of those particular terms.

Identification of terms

Contrasting pre-contractual statements and contractual terms

Pre-contractual statements can be either 'puffs', representations, or form contractual terms. Representations are statements of fact which induce the representee to enter into a contract, but which are not guaranteed by the maker of the statement. It is necessary to make this

classification because it affects the rights of the receiving party depending upon how the pre-contractual statement is categorised:

- (a) if the statement is a puff it has no legal effect at all (subject to consumer protection legislation);
- (b) if the statement is a representation, the receiving party has certain legal remedies depending upon whether the representation was fraudulent, innocent or negligent (see Chapter 9);
- (c) if a statement becomes a contractual term the remedy depends upon whether the term was a condition, warranty or intermediate term.

Whether a statement is a representation or a contractual term depends upon the objective intention of the parties. In *Oscar Chess Ltd v Williams* (1957) (CA) (see below, p 43), Lord Denning stated that 'if an intelligent bystander would reasonably infer that a [term] was intended, that will suffice'. The factors that follow are relevant.

Time of statement

The closer in time between making the statement and entry into the agreement, the more likely it is to be construed as a term. In *Harling v Eddy* (1951) (KB), the defendant (Harling) put up a heifer for auction. As there were no bids, a statement was made that the heifer was in good health and that he would take it back if any problem arose. The plaintiff (Eddy) then made the successful bid for the heifer and entered into an auction agreement. Four months later, the heifer died from tuberculosis that apparently it must have had at the time of the auction. The court held that, given the close proximity between the statement and the auction agreement, the statement was a contractual term that was breached.

Content of statement

If the content of the statement is important to the contract, then it may be more likely that the parties intended it to be a term. In *Couchman v Hill* (1947) (CA), the defendant (Hill) sold the plaintiff (Couchman) a young heifer by auction agreement. The defendant made a statement that the heifer was 'unserved' (that is, without calf) just prior to the plaintiff's successful bid. The heifer was, in fact, pregnant and subsequently died of complications due to being too young for pregnancy. The court held that the statement was a term of importance and therefore was incorporated into the contract.

Statement did not appear in written contract

If a statement is not included in the parties' written contract, then it is unlikely that it was intended to become a term of the agreement (also see parol evidence rule, below).

Statement made by a party with knowledge and expertise

In *Oscar Chess Ltd v Williams* (1957) (CA), the plaintiff (Williams) sold a car (that is, as a trade-in for another car) to the plaintiff (Oscar Chess). The plaintiff described the car as a '1948 model Morris Minor', relying on the registration book. In fact, the car's registration book had been falsified by a previous owner and it was a 1939 model. As the car was worth much less than the agreed price, the plaintiff sued for breach of contract. The court found for the defendant. The statement was not a binding promise but rather an innocent misrepresentation (see Chapter 9). The statement was made by a non-expert to an expert (that is, to a car dealer who should have known the true year of manufacture). By contrast, in *Dick Bentley Productions Ltd v Harold Smith (Motors) Ltd* (1965) (CA), the defendant (Harold Smith) sold a Bentley car to the plaintiff (Dick Bentley). During negotiations, the defendant stated that the car had only done 20,000 miles since having a new engine and gearbox installed. In reality, it was just under 100,000 miles. The court held that the statement was a term of the contract, even though made innocently. Lord Denning stated that the dealer 'was in a position to know, or at least find out, the history of the car'.

Identification of express terms in a contract

This question depends upon whether the contract was oral or in writing.

Oral contracts

If a dispute arises in an entirely oral contract, then the parties will have to present oral testimony to a court as to what the contents of the contract were. The court will, thereafter, objectively assess the evidence and reach a conclusion.

Written agreements and the parol evidence rule

If a dispute arises in an entirely written agreement, then the parol evidence rule is relevant. In *A and J Inglis v John Buttery and Co* (1878) (HL), Lord Blackburn stated that where parties embody their

agreement in a deed, then in order to identify the contractual terms, the 'court must look to the formal deed and that deed alone ... that is only carrying out the will of the parties'. The parol evidence rule is not, however, limited to formal contracts. In *Mercantile Bank of Sydney v Taylor* (1891) (NSW), Innes J stated that where 'a contract is reduced into writing ... it is presumed that the writing contains all the terms of it'. In other words, oral evidence will not be admitted for the purpose of adding to, varying or contradicting the written document. In *Bacchus Marsh Concentrated Milk Co Ltd v Joseph Nathan and Co* (1919) (HC), Higgins J noted that the rule prevented the written words in a contract being contradicted or qualified by the 'uncertain testimony of slippery memory'. In other words, the objective written evidence will override the subjective intention of a party.

There are two further aspects of the parol evidence rule to consider.

Agreement supersedes negotiations

The parol evidence rule presumes that the negotiations that took place between the parties were superseded by the signing of the agreement. In *Nemeth v Bayswater Road Pty Ltd* (1988) (Qld), the plaintiff (Bayswater) entered into a written contract to hire an aircraft to the defendant (Nemeth). The contract contained a specific acknowledgment that 'all the terms of the agreement ... are contained in this [document]'. The plaintiff subsequently sued for additional hire charges that it claimed were due under an oral contract entered into before the written contract was signed. The court held that the written contract contained all the relevant terms and that evidence of any other alleged contract or term was not admissible.

Subsequent conduct

Evidence of any subsequent conduct by the party (or parties) cannot be used for the purpose of construing the terms of a written contract retrospectively. However, the High Court stated, in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) (which is discussed in Chapter 12), that evidence of discussions between the parties to a contract prior to signature was admissible for the purpose of establishing the common understanding of the parties in relation to a matter of fact. This qualification to the parol evidence rules is often referred to as the 'factual matrix concept'.

Exceptions to the parol evidence rule

Oral evidence is generally admissible to establish the following matters.

To prove the parties to a contract

In *Gilberto v Kenny* (1983) (HC), a written agreement to sell land (signed by a 'Mrs Kenny') described the purchaser in one part as 'Mr Kenny' and in another part as 'Mrs Kenny'. The court held that oral evidence was admissible to show that when Mrs Kenny signed the contract she had been acting for herself and as agent for her husband. Obviously, oral evidence may also be given to identify the relationship of a party, or the capacity in which a party contracted (that is, as agent or principal).

To prove that the written document represents only part of the contract

In other words, the parol evidence rule only applies if the contract is totally in writing. The existence of writing, however, is persuasive. In *State Rail Authority of NSW v Heath Outdoor Pty Ltd* (1986) (NSW), McHugh JA stated that the existence of writing provides 'an evidentiary foundation for a conclusion that [the] agreement is wholly in writing'. In other words, the party seeking to rebut this conclusion bears the burden of proving that the contract was not wholly in writing.

To prove that a custom or trade usage is part of a contract

Even though it was not specifically referred to in the written contract, custom or trade usage may be relevant. In *Hutton v Warren* (1836) (Ex), the plaintiff (Hutton) leased a property from the defendant (Warren). The plaintiff disputed a notice to vacate on the basis that the defendant had failed to comply with certain local customs and practices, in particular a rebate for farm work done in the previous year. The court held that the lease agreement, which was silent on this issue, had to be read in the light of established custom. The party seeking to imply the local custom bears the burden of proof.

To prove a condition precedent

In other words, that the operation of the contract is to be suspended until a specific event takes place. In *Pym v Campbell* (1865) (QB), the plaintiff (Pym) entered into a written contract with the defendant (Campbell) to sell an interest in an invention. The defendant later argued that the written contract was subject to a verbal acknowledgment by the plaintiff that the sale was subject to an

inspection and approval of the invention by the defendant's engineer. The engineer did not approve the invention. The court allowed the defendant to give oral evidence and held that the verbal acknowledgment was a condition precedent to the operation of the contract.

To prove an error

That is, that the actual agreement made by the parties has been inaccurately expressed in the written contract. Equity may allow a contract to be rectified so that it represents the true intention of the parties. In *Bacchus Marsh Concentrated Milk Co Ltd v Joseph Nathan and Co* (1919) (HC), Higgins J stated that the aim of rectification is to re-make the written contract 'to accord with what the parties actually agreed to, or with what one party intended and the other party knew the first intended'.

To clarify meaning

That is, clarification of any ambiguous language used in the written contract. The ambiguity must be clear and apparent. In the *Bacchus Marsh* case (above), Higgins J stated that oral evidence may be admissible if it is 'legitimate to show that it was intended to use words bearing a different sense ... when applied to the circumstances'.

Identification of implied terms in a contract

Implied terms are those that are declared to be part of the contract even though the parties have not consciously included them. The courts may be prepared to imply a term into a contract if it is satisfied that the addition is necessary to make the contract reflect the true intention of the parties. Terms may be implied in fact or by the law (common law or statute).

Terms implied in fact

Terms may be implied due to the following circumstances.

Past dealings between the parties

In *Balmain New Ferry Co Ltd v Robertson* (1906) (HC), a notice on the defendant's (Balmain's) wharf stated that a 'fare of one penny must be paid on entering or leaving the wharf. No exception will be made to this rule, whether the passenger has travelled by ferry or not'. The plaintiff (Robertson) paid his penny to get onto the wharf to catch a

ferry, which he missed. The defendant refused to refund the penny required to leave the wharf. The court held that there was an implied term to pay the penny to leave the wharf. The court noted that there was evidence that the plaintiff had used the wharf on many previous occasions and therefore must have been aware of the condition stipulated in the notice.

Custom or trade usage

In *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd* (1986) (HC), the defendant (Con-Stan), through its insurance broker (Bedford), entered into several insurance agreements with the plaintiff (Norwich). The broker, who later went into liquidation, failed to pass on the insurance premiums paid by the defendant to the plaintiff. The plaintiff sought payment and the defendant refused. The defendant argued that there was a commercial custom or practice in NSW that insurers would not pursue clients for non-payment of premiums by brokers. The court held that this was not an industry custom. The court stated that the existence of a custom or trade usage is the question of obvious fact that a reasonable person would imply into a contract, even if one of the parties had a lack of knowledge of it.

To give business efficacy to a contract

In *The Moorcock* (1889) (CA), the plaintiff entered into a contract to dock their ship at the defendant's jetty. Both parties knew that, at low tide, the ship would be resting on the mud at the bottom of the River Thames. When the low tide came, the ship was damaged by a ridge of hard rock under the mud. The plaintiff subsequently sued for damages, claiming there was a breach of an implied term guaranteeing the safety of the river floor. The court implied a term that the defendant had warranted that the river floor was reasonably safe for the ship to lie on. To do so gave business efficacy to the transaction. In *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) (PC), the court emphasised that for a term to be implied, it must be reasonable and equitable, and 'so obvious that it goes without saying' that if a reasonable person were 'asked whether that was the common intention of the parties, the answer would have been 'of course''. In addition, the implied term must be capable of clear expression and must not contradict any express term of the contract. These conditions were endorsed in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) (HC).

Terms implied by common law

When a term is implied by law, rather than fact, it is usually implied because of the nature of the particular contract. In other words, because the term has traditionally been implied in similar contracts.

Examples include the following contracts.

Bailment contracts

The law will imply a term that the bailee will not sell or give away the bailor's goods, and will exercise reasonable care when handling the bailor's goods.

Building and construction contracts

The law will imply a term that the builder will use good quality materials and exercise reasonable care when doing the building work: see *Reg Glass Pty Ltd v River Locking Systems Pty Ltd* (1968) (HC).

Employer and employee contracts

In the absence of an express term, the law will usually imply a term that the employee must exercise proper and reasonable care in carrying out employment duties: see *Lister v Romford Ice and Cold Storage Co Ltd* (1957) (HL). Similarly, the law will imply a term that there is a legal obligation on the employer to provide a safe system of work for the employee: see *Wright v TNT Management Pty Ltd* (1989) (HC).

Professional and client contracts

The law will imply a term in a contract between a professional (for example, solicitor, engineer, etc) and a client, that all reasonable care will be taken in the performance of the contract: see *Brickhill v Cooke* (1984) (NSW).

Statute now regulates much of the above.

Terms implied by statute

For the purposes of this chapter, the discussion will be limited to a brief examination of the consumer protection legislation; namely (Cth) Trade Practices Act 1974 and the State and Territory Sale of Goods legislation.

(Cth) Trade Practices Act 1974

The key provisions include:

- (a) implied undertakings as to title (that is, that the goods are owned by the seller), that the buyer shall enjoy quiet possession of the goods, and that the goods are free of encumbrances: s 69;
- (b) supply by description (that is, goods to correspond): s 70;
- (c) implied undertakings as to quality or fitness of the goods (that is, for the purpose for which the goods were required) and merchantable quality (that is, as with fitness for purpose, the goods are suitable for sale): s 71;
- (d) supply by sample (that is, goods to correspond): s 72.

The legislation only applies to a contract where the seller is a corporation and the buyer is a consumer within the meaning of s 4B. If these requirements are not complied with, then the following State or Territory legislation is relevant.

Sale of Goods legislation

The key provisions include:

- (a) implied terms as to title, encumbrances and quiet possession: NSW/Vic/Tas/NT/ACT, s 17; Qld, s 15; SA/WA, s 12;
- (b) correspondence with description: NSW/Vic/Tas/NT/ACT, s 18; Qld, s 16; SA/WA, s 13;
- (c) fitness for purpose: NSW/Vic/Tas/NT, s 19(1) or 19(a); ACT, s 19(2); Qld, s 17(1); SA/WA, s 14(I);
- (d) merchantable quality: NSW/Vic/Tas/NT, s 19(2) or 19(b); ACT, s 19(4); Qld, s 17(2); SA/WA, s 14(II);
- (e) supply by sample: NSW/Vic/Tas/NT/ACT, s 20; Qld, s 18; SA/WA, s 15.

Identification of collateral contracts

Even if a statement is held to be a mere representation and not a term of the contract, the 'innocent' party may be able to argue that the representation formed a separate, collateral contract, which was subsequently breached. Strictly speaking, a collateral contract is an agreement the consideration for which is the making of some other contract. If a collateral contract is found to exist, it will be enforceable by the innocent party regardless of whether the main contract was valid or enforceable.

The criteria for establishing the existence of a collateral contract are as follows.

Statement is intended as a promise and induces main contract

In *JJ Savage and Sons Pty Ltd v Blakney* (1970) (HC), the plaintiff (Blakney) entered into a contract with the defendant (JJ Savage) for the purchase of a motor cruiser. In the course of negotiations, the plaintiff asked the defendant to recommend a suitable engine, which the defendant did by letter. The subsequent contract made no reference to this recommendation. As the engine failed to live up to the defendant's recommendation, the plaintiff sued for breach of a collateral contract (that is, the promise made in the recommendation). The court refused to infer a collateral contract because negotiations on the main contract were incomplete at the time the recommendation was made. The court stated that a statement will only form a collateral contract if it is promissory and not merely representational.

Statement must not be inconsistent with main contract

In *Hoyts Pty Limited v Spencer* (1919) (HC), the defendant (Spencer) sub-leased premises to the plaintiff (Hoyts) for a four year term. The sub-lease permitted the defendant to terminate the sub-lease at any time by giving the plaintiff four weeks' written notice. The defendant subsequently relied on this clause and gave notice. The plaintiff argued that the termination was in breach of a collateral contract between the parties that the defendant would not take advantage of the termination provision unless he was served with such a notice under the head lease (which was not the situation). The court refused to infer a collateral contract, holding that the statement was clearly inconsistent with the main contract.

Separate consideration is required

There must be a separate consideration for the collateral agreement (see Chapter 4).

Classification of terms

If a statement does become part of a contract then it becomes necessary to determine the importance of it. This step is crucial to assess the remedies that may be available for breach of the relevant term (remedies are discussed in Chapter 13). Contractual terms are traditionally classified into three categories: conditions, warranties and intermediate terms. In addition, terms may be classified as simply definitional or procedural.

Conditions

A condition is an essential term of a contract

In *Bettini v Gye* (1876) (QB), the plaintiff (Bettini) entered into a service contract with the defendant (Gye) to sing in London for specified dates. The defendant subsequently refused to honour the contract because the plaintiff, who had been ill, arrived four days late for rehearsal. The court held that the plaintiff's late arrival was not a breach of a contractual condition because it was a long term contract that included some performances needing no rehearsals. Blackburn J defined a condition as going 'to the root of the matter, so that failure to perform it would render the performance of the rest' of the contract substantially different. In other words, breach of a condition is a serious matter that may entitle the innocent party to be discharged from any further obligations under the contract, in addition to damages (discharge of contract is discussed in Chapter 12). By contrast, in *Poussard v Spiers and Pond* (1876) (QB), the plaintiff's wife (Poussard) was contracted by the defendants (Spiers and Pond) to sing in an opera for specified dates. She took ill just before the opening night and a week passed before she was well enough to sing. The plaintiff sued for breach of contract after his wife was advised by the defendants that she was no longer required for the role. The defendants argued that as her failure to attend on the opening night was a condition, they were entitled to end the contract. The court agreed. The court held that as the illness was of uncertain nature, the only alternatives open for the defendants were either to postpone the opera and suffer financial loss, or engage another opera singer (which occurred). Given the nature of the role, and the difficulty in hiring a temporary substitute, it was reasonable to permanently replace the plaintiff's wife for the season. Blackburn J held that Madame

Poussard's failure to appear went 'to the root of the matter' and consequently, the defendants were discharged from further performance of the contract.

A condition precedent for existence or performance of contract

A condition precedent is an external event that must occur before either a contract comes into existence or the performance under a contract is required. In *George v Roach* (1942) (HC), the plaintiff (Roach) entered into a contract to sell his newsagency to the defendant (George). The contract contained a term that the price should be determined by an independent valuer who was named. The valuer later refused to provide a valuation and subsequent litigation raised the issue as to whether this essential term was a condition precedent. The court held that the necessity for a named valuer to provide the valuation was a condition precedent to the very existence of the contract. In other words, no contract ever came into existence.

A condition subsequent

A condition subsequent is an external event which, when it occurs, brings the contract to an end (for example, a statement that states that if a purchaser is not fully satisfied with goods, they can be returned to the place of purchase and a full price refund given).

Warranties

A warranty is non-essential term of a contract

A breach of a warranty renders a contract different, but not substantially different. As a breach of a warranty is of lesser importance, it only allows the innocent party to sue for damages. It does not permit the innocent party to be discharged from further performance of the contract. Assessing the importance of the term is an objective task, regardless of the language used by the parties in the contract. In *Associated Newspapers Ltd v Bancks* (1951) (HC), the defendant (Bancks), who was the cartoonist who drew 'Ginger Meggs', entered into a publication agreement with the plaintiff (Associated Newspapers). The contract contained a term that the plaintiff would undertake to publish it on the front page of the Sunday comics section. For three successive Sundays it appeared on the third

page of the comics section. The main issue in the subsequent litigation was whether the 'front page' term was a condition or a mere warranty. Given the circumstances, the court held that the term was a condition rather than a warranty because it was of such major significance that the defendant would not have entered into the contract without it.

Sale of Goods legislation

The State and Territory Sale of Goods legislation stipulates that a breach of a warranty does not give rise to a right by the innocent party to reject the goods and terminate the agreement, but rather gives a right to a claim for damages only: NSW/NT/ACT, s 5(1); Vic/Qld/Tas, s 3(1); SA/WA, s 60(1).

Intermediate or innominate terms

This is a complex term that cannot be categorised as either a condition or as a warranty but which may, as the name may suggest, operate as either a condition or a warranty depending on the effect of the breach. The right to terminate the contract will depend upon the nature and extent of the breach of the intermediate term. If the breach is serious or continuing, the innocent party has the right to end the contract. If the breach is minor, or is capable of simple rectification, then the innocent party retains the right to claim damages but must continue with the performance of the contract. In *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* (1962) (CA), a two year ship charter agreement between the plaintiff (Hong Kong) and the defendant (Kawasaki) contained a seaworthiness term that the plaintiff's ship was 'in every way fitted for ordinary cargo service'. This was not true, and the ship was unable to sail for some 20 weeks of the contract. In subsequent litigation, one of the issues was whether the seaworthiness term was a condition or a warranty. The court held that although the plaintiff was clearly in breach of the seaworthiness term, it was not a condition of the charter. The defendant was only entitled to claim damages and not entitled to repudiate the contract. Diplock LJ stated that the court had to decide whether the breach in question deprived one of the parties 'of substantially the whole benefit' which the parties intended the innocent party should obtain. His Lordship went on to stipulate that this is an objective question that will not automatically be determined from a prior classification in the contract of the term as

a condition or as a warranty. In *Cehave NV v Bremer Handelsgesellschaft mbH (Hansa Nord)* (1976) (CA), this analysis was applied to a contract for the sale of goods.

Exclusion clauses

An exclusion clause is a condition that excludes, qualifies or limits the liability of a party for the wrongful conduct specified in that clause. The important characteristic of exclusion clauses is that they operate for the benefit of one party only. The benefiting party will seek to rely on the clause (that is, as a defence) in the event of a dispute, contractual or otherwise, with the other party.

Broadly, there are three categories of exclusion clauses:

- (a) total exclusion of liability: this is where a clause in favour of one party excludes a right that the other party would otherwise have had (see *L'Estrange v Graucob Ltd* (1934) (CA), below, p 58);
- (b) limitation of liability to a specified monetary amount (see *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) (HC), below, p 59);
- (c) placing conditions on the exercise of contractual rights: a common example is a clause requiring a claim to be made within a specified period.

In addition, a contract may contain an indemnity for loss clause that operates if third parties are involved (that is, a clause that indemnifies one party if the other party is sued by a third party).

The success or failure of the exclusion clause will depend upon whether the clause actually forms part of the contract. If a court decides that the clause is relevant, then rules of construction are applied to interpret the effect of the clause.

Relevance of the exclusion clause

An exclusion clause only forms part of a contract if it was brought to the attention of the non-benefiting party. In other words, the benefiting party bears the onus of proving that the other party was aware of the existence and contents of the clause. In the absence of notice, the clause will not form part of the contract.

Notice may be either:

- (a) actual notice: this occurs when the non-benefiting party was actually made aware of both the existence and the contents of the clause; or

- (b) constructive notice: this occurs when the benefiting party has done all that was reasonably necessary to bring both the existence and the contents of the clause to the other party's attention, regardless of whether actual notice took place.

The type of notice required depends upon the nature of the document containing the exclusion clause. If the document is non-contractual in nature, then actual notice will be required. By contrast, if the document is contractual in nature, then constructive notice only may be required.

Notice requirement

When an exclusion clause is contained in a document like a ticket, receipt or notice, several issues arise.

Connecting the document

Would a reasonable person assume that the non-contractual document contained such an exclusion of liability or would indeed form part of a contract at all? In *Causer v Browne* (1952) (Vic), the plaintiff's husband (Causer) left her dress with the defendant (Browne) for dry cleaning. The dress was damaged by the defendant, who then sought to escape liability by relying on an exclusion clause printed on a docket handed to the plaintiff's husband at the time of receipt. The court held that the exclusion clause was ineffective because a reasonable person would have assumed that the docket was an aid to identify the dress for collection and not a contractual document. In *Chapleton v Barry UDC* (1940) (CA), the plaintiff (Chapleton) went to the beach, where he hired a deck chair from the defendant (Barry) council. At the point of hire, there was a notice that set out the hire charge and a request for customers to retain the ticket received for the purpose of inspection. The deck chair hired by the plaintiff was defective and the plaintiff subsequently sued in tort for compensation for his injuries. By way of defence, the defendant sought to rely on an exclusion clause contained on the back of the ticket. The court held that such a defence must fail because a reasonable person would have treated the ticket as a proof of hire, only to be presented for inspection upon request by a council officer.

Reasonable notice

What constitutes reasonable notice is answered by examining the circumstances surrounding the receipt of the document and applying an objective test. In *Parker v South Eastern Railway Co* (1877) (CA), the plaintiff (Parker) left his bag for storage at the defendant's (South Eastern) railway station. The ticket received by the plaintiff had the words 'See back' printed on one side of the ticket. There was a clause on the other side limiting the railway's liability for loss or damage to £10. The plaintiff's bag was subsequently lost and he sued the defendant for the value of the lost bag (£24 10 s). The defendant unsuccessfully sought to rely on the exclusion clause before a jury at first instance. On appeal, the court said that the onus was on the benefiting party to show that it acted reasonably in bringing the existence of the clause to the notice of the other party. The appeal was allowed and a new trial ordered on the basis that the jury was misdirected as to this issue.

Timing of the notice

Does the benefiting party have to give reasonable notice before, and no later than, the making of the agreement? In *Thornton v Shoe Lane Parking Co Ltd* (1971) (CA), the plaintiff (Thornton) drove his car to the entrance of the defendant's (Shoe Lane) car park, took a ticket from the automatic ticket machine, and drove in. The ticket stated that it was 'issued subject to conditions displayed on the premises'. A set of printed conditions was displayed on a sign affixed to a column inside the car park. One condition excluded the parking station from liability for personal injury (that is, a tort). The plaintiff was subsequently injured in the car park in an accident in which the defendant owner of the car park was partly responsible. The plaintiff sued and the defendant unsuccessfully relied upon the exclusion clause. Although the exact moment when the contract was effected was in dispute among the judges, the contract probably arose when the customer took the ticket from the automatic ticket machine. In any event, the court held that the defendant had not done all that was reasonable to bring the clause to the plaintiff's attention before the making of the contract. The notice of the exclusion clause came too late to bind the non-benefiting party to its consequences. A similar result occurred in *Olley v Marlborough Court Ltd* (1947) (CA), where an exclusion notice affixed to a hotel room door came too late for it to form part of the contract between the hotelier and the guest. It is worth noting that in these so called 'ticket cases', the point at which the contract is formed depends upon whether the ticket was handed to the non-benefiting party by a

person or a machine. In the *Shoe Lane Parking* case, Lord Denning stated:

... [If a person hands the ticket] the issue of this ticket was regarded as an offer ... If the customer took it and retained it without objection, his act was regarded as an acceptance of the offer ... These cases were based on the theory that the customer, on being handed the ticket, could refuse it and decline to enter into a contract on those terms. He could ask for his money back ... [If a machine hands the ticket] The customer pays his money and gets a ticket. He cannot refuse it. He cannot get his money back. He may protest to the machine, even swear at it. But it will remain unmoved. He is committed beyond recall. He was committed at the very moment when he put his money into the machine. The contract was concluded at that time. It can be translated into offer and acceptance in this way: the offer is made when the proprietor of the machine holds it out as being ready to receive the money. The acceptance takes place when the customer puts his money into the slot ... He is not bound by the terms printed on the ticket ... because the ticket comes too late. The contract has already been made.

'Harsh' clauses

Will the notice requirement differ if the exclusion clause is particularly detrimental to the non-benefiting party? In the *Shoe Lane Parking* case, Lord Denning stated that if such a clause was 'so wide and so destructive of rights' then the benefiting party would be under an obligation to provide explicit notice, such as printing the clause 'in red ink with a red hand pointing to it ... or something equally startling'. This view was supported in *Interfoto Picture Library v Stiletto Visual Programmes Ltd* (1989) (QB).

Past dealings

Will past dealings make any difference to the notice requirement? In *Balmain New Ferry Co Ltd v Robertson* (1906) (PC) (discussed earlier in this chapter, p 46), the court held that the non-benefiting party was bound by the relevant clause because he had taken frequent similar journeys with the plaintiff and, whether or not he actually knew of the clause, he should reasonably have known of it.

Signing the document

Will it make any difference if the non-benefiting party had signed the document containing the exclusion clause? The general rule is that where the exclusion clause is contained in a signed document, the signatory is bound by the clause unless there was fraud or misrepresentation. It is irrelevant that the signatory may not have actually read the document. In *L'Estrange v Graucob Ltd* (1934) (CA), the plaintiff (L'Estrange) signed a contract for the purchase of a vending machine without reading it. When the machine was delivered, it was defective. In subsequent litigation, the plaintiff argued there was an implied term under the applicable Sale of Goods Act as to fitness for purpose. The defendant sought to rely on a clause in the signed contract that, in effect, excluded this implied term. The court held that the plaintiff was bound by all the terms of the contract, even though she had not read the contents and was unaware that it contained an exclusion clause. The court stated that the plaintiff could not point to any fraud or misrepresentation in her signing the contract without reading it. In *Curtis v Chemical Cleaning and Dyeing Co* (1951) (KB), the plaintiff (Curtis) took her wedding dress to the defendant (Chemical Cleaning) for cleaning and was presented with a receipt that she was asked to sign. When she asked why, the defendant's employee explained that the document exempted the defendant from liability for damage that might occur to the sequins and beads on the wedding dress. The plaintiff signed, the wedding dress was returned stained, and the plaintiff sued. The defendant sought to rely on the exclusion clause that in reality exempted them from liability 'for any damage, however arising'. The court held that the defendant could not rely on the clause because its effect had been misrepresented to the plaintiff (misrepresentation is discussed in Chapter 9).

Construction and interpretation of exclusion clauses

As was noted by Lord Denning in the *Shoe Lane Parking* case, the courts have traditionally viewed exclusion clauses with considerable disfavour, especially where the parties to a contract are not of equal bargaining power.

Commercial agreements

Where the parties are of equal bargaining power, the courts are less hostile to upholding the application of an exclusion clause. In *Photo*

Production Ltd v Securicor Transport Ltd (1980) (HL), the defendant (Securicor) agreed to supply the plaintiff (Photo Production) with a security patrol for their factory. One of the defendant's security guards later lit a fire that destroyed the plaintiff's factory. In subsequent litigation, the defendant relied on a clause in the contract that exempted them from liability for an employee's actions, 'except in so far as such loss is solely attributable to the negligence of the [defendant's] employees acting in the course of their employment ...' The court held that the effect of the clause was that the defendant would only be liable for an employee's actions if it could reasonably have foreseen such actions and have been in a position to avoid them. As the clause was clear and unambiguous, the defendant was able to rely on it, given the facts of this case.

Contra proferentem

The *contra proferentem* rule states that any ambiguity in an exclusion clause will be construed against the benefiting party. In *White v John Warwick and Co Ltd* (1953) (CA), the plaintiff (White) hired a bicycle from the defendant (John Warwick) to enable him to deliver newspapers. The hire agreement was in writing and included a clause exempting the defendant from any liability 'for any personal injuries to the riders of the machines hired'. The plaintiff was injured due to a defective bicycle. In subsequent litigation for both breach of contract and the tort of negligence, the defendant relied on the exclusion clause by way of defence (to both claims). The court, while finding that the clause relieved the defendant from liability for breach of contract, held that as a matter of construction, it did not exclude liability for the tort of negligence. Similarly, in *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) (HC), the High Court applied *contra proferentem* to an ambiguous limitation of liability clause.

Fundamental breach

In *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* (1967) (HL), Upjohn LJ stated that a fundamental breach is one which 'goes to the root' of a contract that entitles the innocent party to repudiate the whole contract. While this statement appears similar to Blackburn LJ's definition of a 'condition' in *Bettini v Gye* (discussed earlier in this chapter, p 51), it is clear that a fundamental breach is the most serious. In other words, it is a breach that is

equivalent to non-performance of the contract. The question to consider is whether a court will allow a party to rely on an exclusion clause that excludes or limits liability for a fundamental breach.

The answer to this question is found in a rule of construction and not in a rule of law. In *Council of the City of Sydney v West* (1965) (HC), the plaintiff (West) parked his car in the defendant's (Council's) parking station. On entry, the defendant's employee handed the plaintiff a ticket with the time printed on one side and some clauses (including an exclusion clause) printed on the reverse side. One clause stated that the defendant did 'not accept any responsibility for the loss or damage to any vehicle ... or for any injury to any person, however such loss, damage or injury may arise or be caused'. The plaintiff's car was stolen due to the negligence of the defendant's employee. The majority held, that as a matter of construction, the clause did not exclude the Council's liability. Barwick CJ and Taylor J stated that the clause did not 'contemplate or provide an excuse for negligence ... in doing something which it is neither authorised nor permitted to do by the terms of the contract'. Windeyer J dismissed any notion that there was a rule of law that would preclude the operation of an exclusion clause in relation to fundamental breach. The question, he said, was 'one of interpretation ... It is not for a court to say that persons may not contract out of [their] obligations'. Despite some decisions to the contrary in England, the House of Lords in *Photo Production Ltd v Securicor Transport Ltd* (1980) (HL) (see above, p 59), held that that the question is essentially one of construction, and that there is no principle of law such that a fundamental breach will automatically invalidate an exclusion clause.

Statutory intervention

Sections 68 and 68A of the (Cth) Trade Practices Act 1974 are relevant to the operation of exclusion clauses. Section 68 renders void any clause that attempts to exclude, restrict or modify the operation of the relevant terms implied by the Act. Section 68A provides some limited exceptions to this prohibition.

Alternative dispute resolution clauses

Many contracts now contain alternative dispute resolution (ADR) clauses. In fact, a commercial contract without an ADR clause is the exception rather than the rule. These clauses generally provide that,

prior to commencing litigation, the parties agree to submit the dispute to an ADR process.

Enforceability of ADR clauses

Although a court may find that such a clause is certain and not incomplete, courts generally will not enforce such clauses because of a lack of an appropriate remedy. For example, a court is unlikely to order specific performance of an ADR clause because courts generally do not have the resources to continually supervise such an order: see *Hooper Bailie Associated Ltd v Natcon Group Pty Ltd* (1992) (NSW). Moreover, courts will generally not award damages as the quantum is too difficult to estimate, given that nobody could tell whether the negotiations would be successful or not: see *Courtney and Fairbairn Ltd v Tolaini Bros (Hotels) Ltd* (1975) (CA).

ADR as a condition precedent to litigation

However, each court generally has the power to order a stay of proceedings under its inherent jurisdiction to prevent an abuse of process (for example, in NSW, such a power is expressed in Supreme Court Rules Pt 13 r 5), the abuse of process being one party's attempt to avoid submitting the dispute to an ADR process as agreed by the contract. In order to prevent such an abuse of process, clauses should be drafted with the requisite certainty and completeness, and make participation in, and finalisation of, an ADR process a condition precedent to commencing litigation. This exception was recognised in *Scott v Avery* (1856) (HL), where Lord Campbell stated that the effect of the clause is that no cause of action arises until after the arbitration has taken place (discussed further in Chapter 11).

Agreements to negotiate in good faith

In England, the courts will not order a stay of proceedings so that the parties may submit themselves to the agreed ADR clause. The English courts view such clauses as being unenforceable because they are void for uncertainty, and courts are unable to estimate damages for breach of such a clause: see *Walford v Miles* (1992) (CA). English courts are even less disposed to recognise an ADR clause expressed to be in good faith. They view such clauses as being repugnant to the adversarial system, as well as not allowing parties to act out of self-interest, should a dispute arise some time after the formation of the contract.

In Australia, the only jurisdiction to have judicially considered this issue in detail is the NSW Supreme Court. While the court is of one mind on the broader issue of the use and effect of ADR clauses, it is divided on its approach to clauses expressing that parties will negotiate in good faith as a condition precedent. In *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) (NSW), the court found that clauses stating that the parties would proceed in good faith to formulate a more comprehensive and detailed joint venture agreement, were not binding because they were too vague, illusory and uncertain to be enforceable. However, Kirby P (Waddell AJA generally agreeing with his reasons) stated in *obiter* that a promise to negotiate in good faith may be enforceable if it is drafted in precise terms, and good consideration has passed between the promisor and the promisee. In his dissenting judgment, Handley JA preferred the English view.

Consequently, in NSW, courts will not enforce ADR clauses, although they will generally order a stay of proceedings, providing the ADR clause is not uncertain or incomplete and is in a *Scott v Avery* form. The use of the words 'good faith' in such clauses is uncertain and awaits a decision of a higher court.

7 Capacity

You should be familiar with the following areas:

- the capacity of parties to enter into contracts
- the doctrine of privity of contract

Once all the essential elements of a contract have been established, the rights and obligations of the parties must be examined. In this chapter, we consider the following:

- (a) the parties to a contract: the law places some limits on the ability or capacity of some classes of persons to enter into a contract; and
- (b) the doctrine of 'privity of contract': in the majority of situations, the parties to a contract will consist of the promisor and promisee. Third parties may, however, accumulate rights under a contract.

Capacity of parties to contract

Even if all the essential elements of contract formation exist, a contract may lack legal effect if one or both of the parties to it lack capacity to contract. Several classes of individuals may lack capacity to contract, including minors, bankrupts, foreign nationals and the mentally challenged. In addition, the Corporations Law places some restrictions on the capacity of companies to contract.

Minors

At common law, a person was an 'infant', in a legal sense, until turning the age of 21. This was also known as 'obtaining one's majority'. The common law rules are, subject to some statutory modification, in force

in the various Australian States and Territories, with the exception of NSW. The age for contractual capacity was reduced to 18 in all Australian jurisdictions in the early 1970s.

Common law

At common law, an infant had contractual capacity if the contract involved either the supply of 'necessaries' or was a beneficial contract of service.

Supply of necessaries

The word 'necessaries' is not confined to goods necessary to support life, but includes goods and services fit to maintain an infant's 'station in life'. The onus falls upon the plaintiff to establish that the goods or services must be necessary at the time they are given to the infant defendant. In *Scarborough v Sturzaker* (1905) (Tas), the court held that the defendant (Sturzaker) was liable to pay for a new bicycle that he had purchased from the plaintiff (Scarborough). The bicycle was necessary for the defendant's 'station in life' because the defendant had to ride 12 miles (19.5 kilometres) to his place of employment. By contrast, in *Bojczuk v Gregorcowicz* (1961) (SA), the court held that, as a matter of law, a loan contract made by the defendant (Gregorcowicz) did not constitute 'a contract for necessaries'. The defendant had borrowed money from the plaintiff (Bojczuk) to pay the costs of her immigration to Australia from Poland. Even though it was established that the loan contract was beneficial to the defendant, Ross J noted that 'she had a job in Poland which, by Polish standards, was a satisfactory one'. As the defendant had not come to Australia for the purpose of providing herself with means of support, the exception did not apply and the defendant had no capacity to enter into the contract.

Beneficial agreements of service

It has long been established that a minor may enter into a contract of apprenticeship or service as a means of earning a livelihood. In *Hamilton v Lethbridge* (1912) (HC), the defendant (Lethbridge) (as a minor) entered into a contract for 'articles of clerkship' (that is, a prerequisite for being admitted as a legal practitioner) with the plaintiff (Hamilton). The contract contained a clause whereby the defendant promised not to practise as a solicitor within 50 miles (80 kilometres) of Toowoomba (that is, the plaintiff's place of business). In addition, the contract contained a clause allowing the plaintiff to

assign the articles to any other solicitor anywhere in Queensland. The court held that the contract was beneficial to the defendant and therefore enforceable against him, notwithstanding that the contract contained clauses that could be regarded as onerous. By contrast, in *De Francesco v Barnum* (1890) (Ch), the defendant (Barnum) entered a seven year contract of apprenticeship with the plaintiff (De Francesco) to learn stage dancing. She agreed that, for the term of the contract, she would neither marry nor accept any professional engagements without the plaintiff's permission. On the other hand, the contract provided that the plaintiff was not bound to employ the defendant, and that he could repudiate the contract if he believed the defendant was unfit for stage dancing. The court held that, given the unduly onerous provisions in favour of the plaintiff, the overall contract was not beneficial to the defendant and she was not bound by it.

Ratification

At common law, it was possible for a minor to 'ratify' an otherwise non-binding contract within a reasonable time after turning 21. In addition, certain contracts (for example, land transactions, purchase of shares or partnership agreements) were regarded as binding upon the minor, unless repudiated by the minor within (again) a reasonable time after turning 21. What may constitute a reasonable time will, of course, depend on the particular circumstances of each case. In *Rain v Fullarton* (1900) (NSW), the plaintiff (Rain) waited nearly two years before commencing proceedings to void a mortgage contract entered into while he was a minor. The court held that the repudiation was ineffectual because of the plaintiff's delay.

Tortious acts

While a minor is generally liable at common law for committing a tortious act, a minor is not liable in tort if it would indirectly enforce an otherwise non-binding contract.

Statutory modification to the common law

Apart from lowering the age of contractual capacity, and with the exceptions of NSW and South Australia that are discussed below, the common law has been modified in the following ways.

Sales of necessities

The State and Territory Sale of Goods legislation now codifies that a minor must 'pay a reasonable price' for 'goods suitable to the condition in life of such' a minor: NSW/Vic/Tas/NT/ACT, s 7; Qld, s 5; SA/WA, s 2.

'Absolutely void' agreements

In Victoria, Queensland and Tasmania, a loan contract with a minor, even for the purchase of necessities, is void. In Victoria and Tasmania, contracts for the sale of goods (other than necessities) or 'accounts stated' (that is, an acknowledgment of debt) are also void.

Ratification

In Victoria, Queensland and Tasmania, a minor cannot ratify a void loan contract upon turning 18 years of age. In Victoria and Tasmania, ratification is not possible for otherwise void contracts for the sale of goods or 'accounts stated'. In Western Australia, Northern Territory and ACT, ratification of otherwise void contracts is possible if it is made in writing and signed.

Position in New South Wales

The (NSW) Minors (Property and Contracts) Act 1970 has replaced the common law with a complete and comprehensive code. The legislation assumes that, unless a minor is so young as to lack understanding, a contract is presumptively binding on the minor. If a contract is presumptively binding, it can be enforced by or against the minor.

Examples of presumptively binding contracts include agreements:

- (a) for the minor's benefit: s 19;
- (b) for the acquisition or sale of property where the consideration is not manifestly excessive at the date of the contract: s 20;
- (c) with a consideration not exceeding the prescribed amount that has prior court approval: s 27;
- (d) for the disposal of property that was signed (not more than seven days before the contract becomes binding) before an independent solicitor or the Public Trustee: ss 28, 29.

Other relevant provisions include the following:

- (a) a minor may 'affirm' (that is, ratify) a non-binding contract upon reaching 18: s 30;

- (b) a minor who has entered into a non-presumptively binding contract may repudiate it at any time prior to turning 19 (s 31), but repudiation is only effective if a minor serves written notice upon the other party: s 33;
- (c) a non-presumptively binding contract will automatically become binding unless the minor effectively repudiates it prior to turning 19: s 38;
- (d) the court has the power to adjust the rights of persons interested in agreements which are repudiated: s 37; in other words, a question of fairness between the parties is taken into account;
- (e) a guarantor of a minor's contractual obligation is legally bound by it, whether or not the agreement is presumptively binding on the minor: s 47;
- (f) a minor may be liable for a tort connected with a contract: s 48.

Position in South Australia

The (SA) Minors' Contracts (Miscellaneous Provisions) Act 1979 is not as comprehensive as the NSW legislation. The relevant provisions are as follows:

- (a) when a minor enters into a contract that would be unenforceable (that is, under the common law because of a lack of contractual capacity), the contract remains unenforceable unless ratified by the minor in writing prior to turning 18, or the day after turning 18: s 4;
- (b) a guarantor of a minor's contractual obligation is legally bound by it, as if the minor had full contractual capacity: s 5;
- (c) a minor may, with prior court approval, enter into a specific contract: s 6;
- (d) if a minor has sold property for some value (that is, for sufficient consideration) the court has a discretion to order the restitution of that property, on such terms as the court believes appropriate: s 7;
- (e) the court may appoint an agent to act on behalf of the minor (for example, in a contract to buy or sell land): s 8.

Bankrupts

A person who has been declared bankrupt continues to have contractual capacity during the period of bankruptcy. However, the

(Cth) Bankruptcy Act 1966 affects the operation and enforcement of a bankrupt's agreements. In addition, the legislation may impact upon contracts entered into before an individual is declared bankrupt.

Mentally challenged and intoxicated persons

The law has long recognised that the capacity of mentally challenged parties to enter into contracts must be carefully scrutinised. Similar reservations apply for parties who are intoxicated by drugs or alcohol.

Knowledge requirement

At common law, a contract made by a person of unsound mind is not voidable at that person's option, if the other party believed, at the time of contracting, that the person was of sound mind. In *Imperial Loan Co v Stone* (1892) (CA), the plaintiff (Imperial) took proceedings against the defendant (Stone) in his capacity as the guarantor of a loan. In his defence, the defendant alleged that when he signed the contract he was insane and incapable of understanding what he was doing. The plaintiff in turn argued that it did not know of the defendant's condition at the time the contract was signed. The court held that the defendant was liable under the guarantee. The court confirmed that the defendant bears the onus of proving 'not merely his incapacity, but also the plaintiff's knowledge of that fact'. This view was approved in *Gibbons v Wright* (1954) (HC).

Statutory intervention

The State and Territory Sale of Goods legislation provides that if goods are supplied as necessaries to a person of unsound mind, then the receiver must pay a reasonable price for the goods: see NSW/Vic/Tas, s 7(1); Qld, s 5(1); SA/WA, s 2(1); NT/ACT, s 7(2).

Intoxicated parties

The above rules also apply to intoxicated persons. The defendant will have to prove that, at the time the contract was entered into, he or she was so intoxicated by alcohol or drugs that understanding was not possible, and that the other party knew or ought to have been aware of the defendant's intoxicated condition. If the intoxication plea is

successful, then the contract is voidable. A voidable contract must be repudiated within a reasonable time of regaining sobriety.

Foreign nationals

The contractual capacity of foreign nationals depends upon the relationship that exists between Australia and the other country in issue, for example:

- (a) if Australia is 'at war', or has imposed economic sanctions (for example, as required by the United Nations), then foreign nationals are not permitted to contract or enforce pre-existing contracts;
- (b) if Australia and the other country are 'at peace', then there are few restrictions on the contractual capacity of foreign nationals, apart from foreign ownership restrictions in assets like land.

Corporations

Capacity to contract is not limited to individual persons. Individuals may form themselves into an association, and this grouping may be incorporated under the Federal and State Corporations Law. A company, as an incorporated association, has the legal capacity of an individual person: see s 161. An unincorporated association has no separate legal capacity.

Privity of contract

In most situations, a contract will only consist of two parties: the promisor and promisee. In other situations, third parties may be given rights under a contract. At common law, however, only the parties to a contract can acquire rights and liabilities under it. Consequently, a third party who benefits under a contract cannot enforce it. This principle is known as 'privity of contract'.

In *Price v Easton* (1833) (KB), a debtor owed certain moneys to the plaintiff (Price). The defendant (Easton) promised the debtor that he would repay the debt if the debtor carried out certain work for the defendant. The debtor completed the work, but the defendant failed to

pay the debt due to the plaintiff. The plaintiff unsuccessfully sued the defendant for failing to pay the debt. The court applied the doctrine of privity of contract and held that the plaintiff could not enforce the contract between the defendant and the debtor. In *Beswick v Beswick* (1968) (HL), an uncle agreed to sell his coal merchant business to his nephew, the defendant, in return for a promise to pay an annuity for life and, following his uncle's death, a smaller annuity to his widow. The uncle later died and the defendant failed to pay the agreed annuity to his aunt, the plaintiff. She successfully sued the defendant. The court held that the widow had no right to sue in her personal capacity, but could sue in her capacity as the administrator of her late husband's estate. As she was not a party to the contract, the principle of privity of contract prevented her from acquiring any legally enforceable rights under the agreement between her husband and his nephew. However, as administrator, she could sue for specific performance of the defendant's promise.

Exceptions to the privity rule

There are quite a number of exceptions to the privity rule.

Agency

Where an authorised agent enters into a contract with a third party on behalf of the principal, the contract is enforceable by both the principal and the third party against each other.

Assignment

Contractual rights may be assigned without the consent of the non-assigning party, provided the contract does not specify to the contrary.

Trusts

A trust is an equitable obligation whereby a trustee holds property on behalf of a beneficiary. If a contracting party is a trustee for a third party, the law allows the third party to enforce any contractual rights held by the trustee pursuant to the trust.

Exclusion clauses

Where an exclusion clause is included in a contract to exclude the liability of one of the contracting parties for any potential breaches, it is often worded so widely as to ensure that the exclusion from liability is extended to anyone acting through or under the benefiting party. In

other words, the clause is designed to protect the servants and agents of the benefiting party who may perform some aspect of the contract.

Negotiable instruments

Negotiable instruments (for example, bills of exchange, promissory notes, and cheques) may be enforceable by a person who was not a party to their creation, provided a valid negotiation of the instrument to the enforcer exists.

Land covenants

The law of real property allows for third parties to be benefited and burdened by contractually created covenants. The covenant is 'annexed' to the land and affects subsequent owners.

Insurance agreements

The (Cth) Insurance Contracts Act 1984 (Cth), s 48, allows a person who is not a party to an insurance contract (that is, a policy), but is specified in that contract, to recover any relevant loss or benefit direct from the insurer.

Manufacturers' liability

Consumers generally purchase goods from retailers (that is, sellers), and not from the manufacturers. The (Cth) Trade Practices Act 1974 (Part V, Division 2A, s 74A–74L) makes manufacturers liable (concurrently with sellers) to consumer claims. The legislation does not create an 'agreement' between the manufacturer and the consumer, but rather gives the consumer statutory rights to pursue the manufacturer in the event of breach.

Trident Insurance: a general exception to the privity rule?

The High Court has now thrown some doubt on the continued existence of the doctrine of privity of contract. In *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) (HC), the plaintiff (McNiece) was the principal building contractor for construction work being carried out at a plant of Blue Circle Southern Cement Ltd. During this time, Blue Circle had an insurance contract (that is, a personal injury policy) with the defendant (Trident). The policy covered Blue Circle (and its subsidiaries, contractors and suppliers) for liability for personal injury. A workman (Hammond) was injured on the construction site and sued the plaintiff for negligence (the accident

took place in 1979 and before the enactment of the (Cth) Insurance Contracts Act 1984). The plaintiff sought an indemnity from the defendant under Blue Circle's policy, but the defendant denied liability. The defendant argued, *inter alia*, by relying on the doctrine of privity of contract (that is, the plaintiff was not a party to the policy). The High Court (by a 5:2 majority) held that the plaintiff was entitled to an indemnity under the policy. The approaches of the majority judges, however, differed to the point that there is no real ratio of the case. The judgments may be summarised as follows:

- (a) Mason CJ and Wilson J: their Honours were prepared to state that the doctrine of privity should be reconsidered, at least in the situation of insurance contracts. Their Honours noted that the rule was often illogical and had historically resulted in unjust and unsatisfactory results for third parties. The insurance policy in issue was conceived to cover relevant third parties.
- (b) Toohey J, who also criticised the doctrine, did not overrule it, but rather found that the doctrine did not apply to these types of insurance policies.
- (c) Gaudron J found for the plaintiff by applying the principle of unjust enrichment (that is, the defendant was unjustly enriched by receiving the premium for a promise to cover Blue Circle and the relevant third parties).
- (d) Deane J was not prepared to abandon the doctrine, but found for the plaintiff by applying an equitable trust (that is, as an exception to the doctrine).
- (e) Brennan and Dawson JJ delivered separate dissenting judgments based upon a continued application of the privity doctrine. They both said it was not appropriate to overturn a well established doctrine, and that justice could be gained for third parties by the application of equitable concepts (that is, as exceptions to the privity doctrine).

8 Mistake

You should be familiar with the following areas:

- the types of mistake the law recognises
- the effect of a mistake at common law and equity
- the plea of *non est factum*

Introduction

Mistake is another factor that may operate to show that the parties did not genuinely consent to the formation of the contract. Given the subjective nature of the doctrine, the law is quite reluctant to grant a party relief on the grounds of mistake. The court is not normally concerned about a party's motive, mistaken or otherwise, for entering into a contract, but rather about a mistake that operates to negative actual assent. In other words, the mistake relates to a matter that operates as condition precedent to the contract.

In Australia, an operative mistake may be one as to fact or law. In *Davis Securities Pty Ltd v Commonwealth Bank of Australia* (1992) (HC), the plaintiff (Davis) made a number of payments to the defendant (CBA) under a loan contract, unaware that it did not actually have to, because these payments contravened the (Cth) Income Tax Assessment Act 1936. When the plaintiff realised its error, it sought to recover the payments from the defendant. The defendant refused, arguing that the payments were not recoverable because the plaintiff had made a mistake of law rather than a mistake of fact. The court disagreed, and held that any previous distinction between a mistake of fact or law no longer applied.

At common law, an operative mistake renders a contract void *ab initio*, not voidable. Consequently, a mistaken party can bring an action to recover any money paid to the other party under the void contract.

Where a contract cannot be declared void at common law, equity may assist the mistaken party in three ways by:

- (a) refusing an order for specific performance;
- (b) declaring a contract voidable (that is, equity can set the agreement aside);
- (c) ordering rectification of a written agreement (see Chapter 13).

There are three types of operative mistake:

- (a) common mistake: where each party makes exactly the same mistake;
- (b) mutual mistake: where the parties misunderstand each other and are therefore at cross-purposes;
- (c) unilateral mistake: where one party is mistaken and the other party knows, or ought to be aware of the mistake made. This category also includes mistake as to the nature of a document or *non est factum* (this is not my deed).

Common mistake

Common mistake occurs when both parties enter into a contract under the same mistaken belief that a certain situation exists or that a relevant fact is correct. In *McRae v Commonwealth Disposals Commission* (1951) (HC) (see below, p 75), Dixon and Fullagar JJ stated that common mistake involves a situation where:

... the parties can be seen to have proceeded on the basis of a common assumption of fact, so as to justify the conclusion that the correctness of the assumption was intended by both parties to be a condition precedent to the creation of contractual obligations.

Common mistake at common law

Common mistake will only render a contract void at common law if the mistake is fundamental, in that it either:

- (a) relates to the very existence of the subject matter of the contract (*res extincta*); or

(b) it involves a sale of property to a person who already owns it (*res sua*).

***Res extincta* (subject matter has perished)**

There can be no actual agreement between two parties if the subject matter has ceased to exist at the time the contract was entered into. In *Scott v Coulson* (1903) (CA), the plaintiff (Scott) entered into a contract with the defendant (Coulson) to assign a life insurance policy where, unbeknown to either party, the assured had already died. Not surprisingly, the court held that the assignment contract was void for common mistake. In *Couturier v Hastie* (1856) (HL), the plaintiff (Couturier) owned corn that the defendant's (Hastie's) agent had agreed to sell upon arrival in England. The defendant in turn entered into a contract to sell the corn to a purchaser. Unbeknown to all parties, a few days before the sale, the corn began to overheat and had to be sold *en route*. When the purchaser discovered what had happened to the corn, he repudiated the contract. In subsequent litigation, the court held that the purchase contract was void because the corn had ceased to exist at the time the contract was entered into. Consequently, the defendant was not liable to the plaintiff under the agency contract.

The State and Territory Sale of Goods legislation now codifies this common law position when there is a contract for the sale of specific goods: see NSW/Vic/Tas/ACT, s 11; Qld, s 9; SA/WA, s 6; NT, s 10.

Warranty as to existence of subject matter

This form of common mistake is not to be confused with a situation where one of the parties actually promises that the subject matter exists. In *McRae v Commonwealth Disposals Commission* (1951) (HC), the defendant (Commonwealth) invited tenders 'for the purchase of an oil tanker lying on Jourmaund Reef, which is approximately 100 miles north of Samarai'. The plaintiff's (McRae's) tender of £285 was accepted and he subsequently spent a further £3,000 mounting a recovery expedition. In fact, no such reef existed and there was no tanker in the area stated. When the plaintiff sued the defendant for breach of contract, the defendant argued the contract was void for common mistake. The Victorian Supreme Court agreed, following *Couturier v Hastie*, but nevertheless gave the plaintiff damages for fraud. The High Court reversed this decision, finding that common mistake did not apply. The effect of the contract was that the defendant

had warranted the existence of the oil tanker and was liable when that warranty proved to be unfounded. According to Dixon and Fullager JJ:

... [the plaintiffs] knew nothing except what the Commission had told them. If they had been asked, they would certainly not have said: 'Of course, if there is no tanker, there is no contract.' They would have said: 'We shall have to go and take possession of the tanker. We simply accept the Commission's assurance that there is a tanker and the Commission's promise to give us that tanker.' ... Since there was no such tanker, there has been a breach of contract, and the plaintiffs are entitled to damages for that breach.

Mistake as to substance of subject matter

A common mistake can only be made as to the substance, and not the quality or attributes, of the subject matter in a contract. In *Bell v Lever Bros Ltd* (1932) (HL), the plaintiff (Lever), which had a controlling interest in a subsidiary company (Niger), entered into five year service agreements with the defendant (Bell) and another (Snelling), who were employed to manage Niger. Three years later, both the defendant and Snelling entered into generous redundancy agreements with the plaintiff. Soon after the redundancy payments were made, the plaintiff discovered that both the defendant and Snelling had, during the term of their employment, and in breach of their service agreements, engaged in some private financial transactions resulting in secret profits. If the plaintiff had known about these breaches, it would have been able to dismiss the defendant and Snelling without making redundancy payments. In subsequent litigation, the plaintiff argued that the redundancy agreement was void for common mistake, in that both parties had entered into it believing that the plaintiff was obliged to compensate the defendant for early termination. Both the trial judge and the Court of Appeal agreed. However, the House of Lords held (in a 3:2 decision) that the common mistake related only to quality of the redundancy agreement and not its subject matter, and, therefore, the redundancy agreement was not void. The majority held that the actual subject matter of the redundancy agreement was not mistaken, as both parties believed, correctly, that it related to the termination of the defendant's employment. It was immaterial (according to Lord Atkin) that the defendant's termination could have been achieved by alternative means.

In *Leaf v International Galleries* (1950) (CA) (discussed also in Chapter 9, with regard to innocent misrepresentation), there was a

contract to buy a painting of Salisbury Cathedral, and both parties were under the same mistake as to the true identity of the painter (that is, Constable). The court held that, although the mistake was essential or fundamental, it was still only a mistake about the quality of the subject matter, and not about its identity or substance. The plaintiff (Leaf) had agreed to buy, and did in fact buy, a specific chattel, namely a painting of Salisbury Cathedral. Although there is a considerable difference between a Constable painting and a non-Constable one, the court stated that it was merely a difference in quality and value, rather than in the substance of the thing itself. A similar view was taken by the High Court in *Svanosio v McNamara* (1956) (HC). In this case, the plaintiff (Svanosio) contracted to buy land 'together with licensed premises known as the 'Bull's Head Hotel' erected thereon'. Following completion of the conveyance, a survey revealed that part of the hotel building fell outside the boundaries of the land conveyed. In subsequent litigation, the plaintiff asked the court to set aside the contract and order the return of the purchase moneys on the basis of common mistake. The court declined, as the contract was fully performed and there was no evidence of fraud or a total failure of consideration. The court, nevertheless, noted that the plaintiff might have been entitled to seek rescission, had such been sought before completion of the conveyance.

***Res sua* (subject matter already owned)**

In *Cooper v Phibbs* (1867) (HL), the plaintiff (Cooper), following his uncle's death, entered into a contract with the defendants (Phibbs), the daughters of the deceased uncle, to lease a salmon fishery. All parties wrongly believed, at the time of the contract, that the deceased uncle was the legal owner of the property and that it had been inherited by the defendants. The plaintiff later sought to have the lease set aside when he discovered that he was, in fact, the true owner. The court held that the lease was a nullity.

However, as with *res extincta*, the court will carefully examine the subject matter of the mistake. In *Bligh v Martin* (1968) (Ch), the plaintiff (Bligh) granted the defendant (Martin) a grazing lease over several fields. Unbeknown to both parties, one of the grazing fields actually belonged to the defendant. In subsequent litigation, the court held that the grazing lease was still valid, notwithstanding *res sua*. The grazing field in dispute represented less than one-tenth of the total area of the grazing lease. Consequently, the mistake in the subject matter was not fundamental.

Common mistake in equity

In *Associated Japanese Bank (International) Ltd v Crédit du Nord SA* (1989) (QB), Stein LJ stated that a court will examine first whether a contract is void at common law, and if not, it will examine secondly whether equity may grant relief. Equity may, contrary to the common law, grant relief where the common mistake relates only to the quality, nature or value of the subject matter.

Setting aside a contract

Equity can set aside a contract on such terms as it thinks fit. In *Solle v Butcher* (1950) (CA), the defendant (Butcher) leased a flat to the plaintiff (Solle) for seven years at a fixed annual rental of £250. At this time, both parties incorrectly believed that the flat was not subject to rent restrictions. Two years later, after discovering that the proper rent payable was only £140 per annum, the plaintiff brought an action against the defendant claiming the excess rent paid, and a declaration that he could remain in the flat for the remainder of the lease for £140 per annum. The defendant, in turn, sought a declaration that the lease was void for common mistake. The court held that the lease was not void for common mistake. Nevertheless, the court was prepared to conditionally set the lease aside. In his judgment, Denning LJ stated that in situations of mistake, equity may be prepared to intervene and set aside a contract 'so long as it could do so without injustice to third parties ... [and] it was unconscionable for the other party to avail himself of a legal advantage which he had obtained'. Therefore, it appears that equity will only intervene if the following five conditions can all be satisfied:

- (a) there was a common misapprehension;
- (b) the misapprehension was of a fundamental nature;
- (c) the party seeking the equitable relief must not be at fault;
- (d) it must be unconscionable to allow the other party to benefit from the mistake;
- (e) the rights of third parties must not be unjustly affected.

Rectification

When parties to a contract subsequently execute a written document that, by mistake, fails to accurately reflect their agreement, equity may

order that the mistaken part in the written document be rectified. This is achieved by an order that the mistaken part be removed from the written document and replaced with words that accurately reflect the agreement. In other words, the purpose of rectification is to make the written instrument a true record of that agreement or intention.

In *Frederick E Rose (London) Ltd v William H Pim Junior and Co Ltd* (1953) (CA), the plaintiff (Rose) received an order from a customer to supply 'Mexican horsebeans here described as feveroles'. The plaintiff in turn ordered the goods from the defendant (Pim) after being assured that 'horsebeans' and 'feveroles' were the same thing. Their oral contract was later reduced to writing and referred only to the purchase of 'horsebeans'. When the plaintiff discovered that 'horsebeans' were not 'feveroles', it sought, *inter alia*, to have the contract rectified by substituting the word 'feveroles' for 'horsebeans'. The court refused rectification because there was no actual difference between what the parties had orally agreed to and what they had subsequently reduced to writing. Although the parties were under a common mistake in believing that 'horsebeans' and 'feveroles' were identical, the written contract accurately reflected what the parties had agreed to. In the words of Denning LJ, 'rectification is concerned with contracts and documents, not with intentions'. A similar view was expressed by the High Court in *Pukallus v Cameron* (1982) (HC). In this case, the plaintiff (Pukallus) purchased land from the defendant (Cameron) described in their contract as 'Subdivision 1 of Portion 1154'. Both parties wrongly believed that the land contained a bore and cultivation. This mistake was not discovered until after settlement of the conveyance. The plaintiff's action for rectification failed because he failed to establish convincing evidence that the written contract did not embody the final intention of the parties. According to Wilson J (Gibbs CJ and Murphy J agreeing), there was:

... no evidence to support a finding of an intention to contract for the sale of the bore and cultivated area. The intention was to effect a transfer of Subdivision 1 of Portion 1154, a parcel of land which was thought, erroneously, to include the bore and cultivated area. If the mistake has been discovered before the conveyance was effected, the appellant could, no doubt, have avoided the contract. In view of the uncertainty surrounding the location of the boundary, which was manifest throughout the negotiations, it would clearly have been prudent for the appellants to have undertaken their own survey, or to have insisted on the respondent fulfilling his undertaking in that regard.

Mutual mistake

Mutual mistake occurs when both parties to a contract are at cross-purposes as to the subject matter, and if there is no 'meeting of minds', there is no agreement between the parties. The contract is void, not because the subject matter did not exist at the time of the contract, but because the parties have not reached a contract about the same subject matter. As with common mistake, it is necessary to distinguish the common law position from that which developed in equity.

Mutual mistake at common law

The question of mutual mistake must be determined objectively. In other words, the question is whether, on the facts available, a reasonable person would infer that there was actual contract between the parties. In *Raffles v Wichelhaus* (1864) (Ex), the plaintiff (Raffles) sold the defendant (Wichelhaus) '125 bales of Surat cotton' to be shipped 'ex *Peerless* from Bombay'. In reality, there were two ships called *Peerless*. The evidence showed that the plaintiff was thinking of the *Peerless* which sailed from Bombay in December, and the defendant was thinking of the other *Peerless*, which also sailed from Bombay, but in October. In the ensuing litigation, the court held that there was no agreement between the parties. While the court gave few reasons for its decision, the existence of any contract between the parties could not reasonably be inferred because of their mutual mistake regarding the ship *Peerless*.

The contract will be enforced if a reasonable person can attribute a meaning to it. In *Goldsborough Mort and Co Ltd v Quinn* (1910) (HC), the defendant (Quinn) agreed to sell the plaintiff (Goldsborough) certain land for £1 10 s per acre 'calculated on a freehold basis'. At the time of the contract, the defendant's land was Crown leasehold title and not freehold title. Consequently, there would be some expense in converting the leasehold to freehold. A dispute later arose as to which party would pay the cost of conversion, which was 20 s per acre. The defendant argued that his understanding of the agreement was that he would get £1 10 s per acre net. The plaintiff argued that, as it was paying £1 10 s per acre 'calculated on a freehold basis', it was buying freehold land, and therefore the cost of conversion was the defendant's responsibility. The court agreed with the plaintiff and found that the statement was not ambiguous. A reasonable person could only put one interpretation on the words used, namely, that the defendant was responsible for the conversion costs.

Mutual mistake in equity

As with common mistake, equity follows the common law in relation to mutual mistake. In exceptional cases, equity has refused to order specific performance, or has set aside contracts held valid at common law for reasons of injustice or undue hardship. Given that mutual mistake involves contractual parties at cross-purposes, rectification is obviously not available.

Unilateral mistake

Unilateral mistake occurs when only one of the parties to a contract is mistaken, and the other party is aware of that mistake, or in the circumstances should have been aware of that mistake. The mistake can be as to a term of the contract, or as to the identity of the other party, but will be of no consequence unless it is fundamental to the actual contract. As with both common and mutual mistake, it is necessary to distinguish the common law position from that which developed in equity.

Unilateral mistake at common law

Unilateral mistake usually involves fraud on the part of (one of) the non-mistaken party to a contract, although this is not an essential element. The unilateral mistake may arise in relation to the terms of the contract or as to the identity of the other party to the contract.

Unilateral mistake as to terms

When the unilateral mistake relates to a term, the contract may be declared void provided the mistake is of fundamental importance. In *Hartog v Colin and Shields* (1939) (KB), the plaintiff (Hartog) entered into a contract to buy 300,000 Argentine hare skins from the defendants (Colin and Shields). During their pre-contract negotiations, the parties discussed the price per piece, which was the industry practice. When the plaintiff offered to buy at 10 pence per piece, the defendants counter offered with 10.25 pence 'per pound'. The plaintiff immediately accepted, given that this offer equated to 3.75 pence per piece. When the defendants realised their mistake, they refused to

complete the contract and the plaintiff sued for breach. The defendants argued that the contract was void because their mistake was fundamental to its formation, and because their mistake was evident, or should have been evident, to the plaintiff. The court agreed and the contract was held void.

There is now doubt, however, whether a unilateral mistake as to terms can operate to render a contract void. In *Taylor v Johnson* (1983) (HC), the defendant (Johnson) entered into a contract with the plaintiff (Taylor) for the sale of 10 acres of land for the total price of \$15,000. The defendant subsequently refused to complete, claiming that she believed that the sale price was \$15,000 per acre (that is, a total purchase price of \$150,000). In the ensuing litigation, the plaintiff sued for specific performance, and the defendant sought an order for either rectification or the setting aside of the contract. The trial judge found that the defendant was mistaken about the sale price, but ordered specific performance, finding that the plaintiff was unaware of the mistake. The NSW Court of Appeal unanimously upheld the defendant's appeal, each judge concluding that the plaintiff knew, or ought to have known, about the defendant's mistake. The plaintiff's appeal to the High Court was successful in part. The court (by a 3:1 majority) held that the agreement was not void for unilateral mistake. Nevertheless, the court also held that the contract should be rescinded on equitable grounds (discussed below, p 85). The majority (Mason ACJ, Murphy and Deane JJ) relied on the view expressed by Denning LJ in *Solle v Butcher* (1950) (see above, p 78):

... once a contract has been made, that is to say, once the parties ... have to all outward appearances agreed with sufficient certainty in the same terms on the same subject matter, then the agreement is good unless and until it is set aside for failure of some condition on which the existence of the agreement depends, or for fraud, or for some equitable ground. Neither party can rely on his own mistake to say it was a nullity from the beginning, no matter that it was a mistake which to his mind was fundamental, and no matter that the other party knew he was under a mistake.

Unilateral mistake involving mistaken identity

Not every unilateral mistake as to the identity of a party to a contract will result in a void outcome. One party's mistake as to the character or worthiness of the other party is generally considered irrelevant, in the same way that a mistake as to the quality or other attributes of the

subject matter does not amount to a mistake in substance. A mistaken party may rebut this by showing that:

- (a) the actual identity of the other party was of vital importance to the formation of the contract;
- (b) the mistaken party intended to deal with someone other than the other party;
- (c) the other party knew of, or ought to have known of, the mistake as to identity.

The mistaken party will find it easier to rebut the presumption in favour of intention to contract when the parties have contracted at a distance, rather than face to face.

Mistaken identity: contracting at a distance

In *Cundy v Lindsay* (1878) (HL), the plaintiff (Lindsay) received an order to supply a large quantity of handkerchiefs to a criminal called Blenkarn who gave his address as 37 Wood Street, Cheapside. The order was signed in such a way that the purchaser's signature appeared to be 'Blenkiron and Company', which was a respectable business located at 123 Wood Street, Cheapside. As the plaintiff mistakenly believed that the purchaser was Blenkiron and Company, he supplied the goods to Blenkarn on credit. On receiving the goods, Blenkarn sold them to the defendant (Cundy), and disappeared. When the plaintiff discovered the truth, he sued the defendant in the tort of conversion, arguing that the sale to Blenkarn was void for unilateral mistake. The court held that since the plaintiff had only intended to enter into a contract with Blenkiron and Company, and not with the criminal Blenkarn, the contract was void. The innocent defendant was, therefore, liable to the plaintiff in tort.

Mistaken identity: face to face dealings

It is difficult to rebut the presumption in favour of intention to contract when the agreement in question was entered into face to face. In *Phillips v Brooks Ltd* (1919) (KB), a criminal called North went to the plaintiff's (Phillips) jewellery shop and purchased an emerald ring for £450 by cheque, pretending that he was Sir George Bullough. The plaintiff knew of 'Sir George' by reputation, and verified that the residential address given by North actually belonged to Sir George. When the cheque was subsequently dishonoured, the plaintiff traced the ring to the defendant (Brooks), a pawnbroker, with whom North had pledged it for £350. The plaintiff sued in conversion, alleging that

the contract between himself and North was void for unilateral mistake. The court held that the contract was not void, but voidable. The court then refused to set the contract aside, as an innocent third party (that is, the defendant) had acquired an interest in the ring prior to the plaintiff avoiding the contract. The plaintiff's only action was against North. The court decided that the plaintiff was not concerned with the actual identity of the purchaser, but rather his creditworthiness. In other words, the plaintiff was only concerned with a mere attribute of the purchaser's identity. A similar result was reached in *Lewis v Averay* (1972) (CA), where the plaintiff (Lewis) sold his car to a man he believed was Richard Greene, a well known English actor and star of the 1950s 'Robin Hood' television show. Before the plaintiff was advised that the purchaser's cheque had bounced, the car was sold to the innocent defendant (Averay). The plaintiff sued in the tort of conversion, arguing that the contract with the purchaser was void for unilateral mistake. As in the previous case, the court held that the contract was only voidable and that, as the car had been sold to an innocent party, the right of rescission had been lost. In his judgment, Lord Denning MR criticised the earlier decision of *Ingram v Little* (1961) (CA), which, in similar circumstances, had found that the plaintiff (Ingram) had rebutted the presumption in favour of intention to contract.

Unilateral mistake at equity

The following remedies may, in certain circumstances, be available at equity.

Refuse specific performance

As equity generally follows the common law, it will refuse to order specific performance of a contract declared void for unilateral mistake. However, in circumstances where the other party has not contributed to the unilateral mistake, specific performance may be ordered unless it would impose undue hardship upon the mistaken party. In *Webster v Cecil* (1861) (Ch), the defendant (Cecil) wrote to the plaintiff (Webster) offering to sell him certain land for £1,250. The plaintiff accepted, knowing that the defendant was in error and the price should have been £2,250 (the defendant had previously rejected the plaintiff's offer of £2,000). In the subsequent litigation, the court refused specific performance. While the court acknowledged that the plaintiff might have had a good argument at common law, equity would not compel a party to sell property for much less than its real

value. By contrast, in *Fragomeni v Fogliani* (1968) (HC), the court ordered specific performance of a contract because it would not cause the mistaken party undue hardship.

Set aside agreement

Equity may set aside a contract if it would be unconscionable to allow the non-mistaken party to take advantage of the other party's mistake. In *Taylor v Johnson* (1983) (HC) (discussed above, p 82), the court noted that the following 'special circumstances' need to be established before it would be unconscionable for the non-mistaken party to enforce the contract:

- (a) the mistake was induced by a material misrepresentation by the non-mistaken party;
- (b) the non-mistaken party, who knows prior to entering into the contract that the other party is mistaken, allows the mistake to continue and concludes the contract instead of pointing out the mistake;
- (c) the non-mistaken party, who knows prior to entering into the contract that the other party is mistaken, deliberately sets out to ensure that the mistaken party does not become aware of the existence of the mistake.

Rectification

As discussed earlier (see common mistake, p 78), where there has been a mistake in reducing the contract to writing, equity may order rectification of the document so that it coincides with the actual agreement of the parties. Nevertheless, it is doubtful if this remedy is available for unilateral mistake. In *Riverlate Properties Ltd v Paul* (1975) (CA), the plaintiff (Riverlate) entered into a lease with the defendant (Paul) under which the defendant was not responsible for any repairs to the premises. This was not what the plaintiff had intended. The court refused to order rectification because the defendant was unaware of the plaintiff's mistaken intention and in no way contributed to the mistake being made. It appears that some fault or sharp practice on the part of the non-mistaken party is required before rectification will be available for unilateral mistake.

**Mistake as to the nature of the document signed
(*non est factum*)**

The defence of *non est factum* (this is not my deed) appeared in the 16th century to prevent an illiterate or blind party being defrauded by virtue of a written contract. The principle was that the law should give relief to an innocent signer of a contract whose consent is genuinely lacking. In *Thoroughgood's* case (1584) (CCP), an illiterate (Thoroughgood) signed what one John Ward had told him was a release of rental arrears in favour of William Chicken. In reality, the document transferred Thoroughgoods' property to Chicken. The court held that the document was not binding on Thoroughgood because it had been falsely explained to him before signature.

In order for the defence to succeed in modern cases, the mistaken party must satisfy three elements:

- (a) that the document which was signed was radically different in character or effect from what the signing party thought was agreed;
- (b) that the signing party was not careless in signing the document without verifying its contents;
- (c) that no innocent third party will suffer undue hardship.

In *Gallie v Lee* (1969) (CA), affirmed in *Saunders (Executrix of the Estate of Gallie, deceased) v Anglia Building Society* (1971) (HL), the plaintiff (Gallie), a 78 year old widow who wished to transfer her property to her nephew (Parkin), signed a document which in fact transferred her property to the defendant (Lee). The defendant, who was a business associate of her nephew, had told the plaintiff that the document was necessary to effect the gift to her nephew. The plaintiff had not read the document before she signed it because her glasses were broken. The defendant subsequently mortgaged the property to a building society for £2,000 and used the money to pay off his personal debts. When the defendant defaulted on the mortgage, the building society sought possession of the house. The plaintiff, in turn, sought a declaration that the contract with the defendant was void, arguing *non est factum*. While the plaintiff succeeded at first instance, her plea of *non est factum* was rejected by the Court of Appeal. When the plaintiff died, her executrix appealed to the House of Lords. The court also rejected the defence because, in the court's opinion, there was not a fundamental difference between what the plaintiff thought she was signing, and the actual document signed. Both documents would have involved the transfer of her property, and the only difference was the beneficiary of

the transfer. The court also held that the plaintiff was careless in not taking adequate precautions to ensure that the document she signed was what she thought it to be. Lastly, the court held that the defence could not be used to defeat the rights of the innocent third party (that is, the building society who paid out money on the faith of the plaintiff's agreement with the defendant). Clearly, on the facts, the plaintiff failed to establish the three elements of the defence.

The defence was accepted by the High Court in *Petelin v Cullen* (1975) (HC). The defendant (Petelin), a man who spoke little English and could neither read nor write in English, gave the plaintiff (Cullen) an option to purchase his land in exchange for a \$50 payment. The option was for six months. When it expired, the plaintiff sent the defendant a further \$50 and later asked the defendant to sign a document purportedly acknowledging receipt of the second \$50 payment. The defendant signed the receipt, believing that it was an additional payment related to the original option agreement. In reality, the defendant had signed an extension of the option that the plaintiff subsequently exercised. When the defendant refused to transfer the property, the plaintiff sought specific performance. The court accepted that the defence of *non est factum* had been made out, and refused to grant specific performance. On the available evidence, the three elements of the defence had been clearly established.

9 Misrepresentation

You should be familiar with the following areas:

- the elements to establish misrepresentation
- categories of misrepresentation
- rescission of a contract for misrepresentation

Introduction

A misrepresentation is an untrue statement that induces the representee to enter the contract. The statement can be made either before, or at the time of entering the contract. If the statement forms part of the contract, any remedies will be based upon breach of a term. However, if the statement does not form part of the contract, the representee may be able to seek relief based upon misrepresentation itself. A finding of misrepresentation renders the agreement voidable at the option of the representee. In other words, the innocent party can rescind the contract and, depending on the circumstances, claim damages.

There are five elements that the representee must establish in order to plead misrepresentation:

- (a) it was made by the representor to the representee either directly or indirectly;
- (b) it was a statement of fact and not a representation as to opinion, intention or law;
- (c) it was false;
- (d) it was intended to induce the representee to enter into the contract;
- (e) it acted as an inducement to enter the contract.

First element (representation made either directly or indirectly)

Proving a direct representation is a simple question of evidence. Proving an indirect representation is more complex. As a general rule, silence is not a representation. In other words, there is no general duty to advise the other party of all that is known about the subject matter of the contract. After all, the other party should carry out independent investigations to remove any doubts about the integrity of the contract. In *Spooner v Eustace* (1963) (NZ), the defendant (Spooner) sold a property to the plaintiff (Eustace), knowing that the outside stairway encroached upon an adjoining property. In subsequent litigation the court held that the defendant's failure to disclose the existence of the encroachment did not amount to a misrepresentation, as the purchaser should have properly investigated the title (statute now requires 'vendor disclosure' of such matters in most jurisdictions). There are, nevertheless, five exceptions where silence or non-disclosure can constitute actionable misrepresentation.

Statement becomes untrue

The first exception stems from the fact that the representor is now aware that the statement is untrue and must take positive steps to correct the misrepresentation. In *With v O'Flanagan* (1936) (CA), the defendant (O'Flanagan) represented to the plaintiff (With) that his medical practice produced a yearly income of approximately £2,000. This statement was true at the time the statement was made, but not by the time the contract was signed. The court held that the plaintiff was entitled to rescind the contract and recover the moneys paid because the defendant was under a duty to disclose the change of circumstances.

Half-truths

The second exception relates to the distortion of positive representations (that is, half-truths). Where a representation states some facts and omits others, then only part of the truth is revealed. If the true part is held out by the representor as the whole truth, and this is misleading, the representation may constitute operative misrepresentation in favour of the representor. In *Dimmock v Hallett*

(1866) (Ch), the plaintiff (Hallett) made the successful bid at an auction to purchase a farming property from the defendant (Dimmock). In subsequent litigation, the plaintiff argued that he was induced by misrepresentation, in particular, certain statements made in relation to the occupying tenants, and the rents payable, which turned out to be only partially true. The court held that the rental value statements were a misrepresentation because the representor knew they were only partly true. In *Jennings v Zilahi-Kiss* (1972) (SA), the defendant (Zilahi-Kiss) owned a residential property that was classified by a local council regulation as a lodging house. Under this classification, no cooking stoves were allowed to be installed in any room or corridor. In contravention, cooking stoves had been installed in each room, and this enabled the rooms to become self-contained. The council, upon becoming aware of the breach of regulations, wrote to the defendant and requested compliance. In the interim period, the plaintiff (Jennings) purchased the property after the defendant had advertised it as a 'large home plus five modern flats'. After discovering the truth, the plaintiff sought to rescind on the basis of misrepresentation. The court agreed, notwithstanding that the statement made was in fact true, because the rooms were let as self-contained flats, although in contravention of local government regulations. The statement was a misrepresentation because it falsely portrayed the whole truth.

Active concealment

The third exception relates to the situation where the representor actively conceals from the representee the truth about a crucial fact, for example, a defect in a house. In *Schneider v Heath* (1813) (CCP), the plaintiff (Schneider) agreed to purchase a second hand boat from the defendant (Heath). The contract provided that the boat was sold 'with all faults'. The pre-purchase inspection of the boat took place while it was moored, and the water concealed a broken keel and rotten hull. At that time, the defendant stated that the 'hull [was] nearly as good as when she was launched ... [the boat] will only require a most trifling outfit'. The court held that a contractual qualification, such as in this case where the boat be purchased 'with all faults', will not protect a seller who is guilty of positive fraud. The court was satisfied that the defendant committed a fraud, not only in spoken representation, but also in using a means to conceal the defects.

Uberrimae fidei (utmost good faith)

The fourth exception relates to certain contracts where the parties are under an obligation to disclose all relevant facts, so that any non-disclosure by one party may give rise to a right of rescission by the other party. The obligation arises in situations where only one of the parties possesses full knowledge of all the material facts and, as a consequence, must display utmost good faith in revealing them. Strictly, the contract is voidable for non-disclosure rather than for misrepresentation. Examples include insurance policies, contracts for the purchase of shares in a company, partnership agreements, and family arrangements. In *Gordon v Gordon* (1821) (Ch), the plaintiff and defendant, who were brothers, entered into a contract to divide the family estate. The plaintiff accepted a lesser settlement because he wrongly believed he was illegitimate and, under prevailing law, had no inheritance rights. The defendant knew that the plaintiff was legitimate and deliberately failed to disclose the truth. Some 19 years later, the plaintiff discovered the truth, and successfully sued to have the family arrangement set aside. The court held that it was not the 'falsity of the belief' that was important, but rather the failure by the defendant to make full disclosure of a material fact which the law demanded of him.

Fiduciary relationships

The fifth exception applies to a situation where the parties to the contract share a confidential relationship, and where the law imposes a duty to disclose to each other any material facts of which they are aware. There are certain recognised examples of such fiduciary relationships:

- (a) parent and child;
- (b) principal and agent;
- (c) solicitor and client;
- (d) trustee and beneficiary.

Second element (representation is a statement of fact)

The representation must be a statement of past or present fact. Statements of opinion, intention, or of law, are not representations. In addition, sales 'puffs' must be distinguished from statements of fact.

Statement of opinion

An opinion is only a statement of belief based on grounds incapable of actual proof. Statements of opinion cannot found an action in misrepresentation unless the representor warrants the truth of it. The representee can choose to verify the statement or not, and the latter is done entirely at the representee's own risk. In *Bissett v Wilkinson* (1927) (PC), the defendant (Bissett), while negotiating with the plaintiff (Wilkinson) to sell his farm, stated that it would accommodate 2,000 head of sheep, even though it had never been used to run sheep. The plaintiff later sought to rescind the contract when he discovered that the farm could not carry anywhere near that number of sheep. The court held that the statement was not misrepresentation, but merely an honest opinion as to the carrying capacity of the property that the plaintiff could have investigated.

A court may be prepared to hold the statement as one of fact, rather than opinion, if it can be proved that in relation to the opinion stated, either:

- (a) the representor did not actually hold the opinion stated;
- (b) the opinion was based on facts of which only the representor knew, and about which the representee had no knowledge.

In *Smith v Land and House Property Corporation* (1884) (CA), the defendant (House) agreed to purchase a hotel from the plaintiff (Smith) after they were advised that the property was 'let to ... a most desirable tenant'. In reality, the tenant was less than desirable. The defendant refused to complete the contract when it discovered that the tenant's company, which operated the hotel, had gone into liquidation. In subsequent litigation, the defendant successfully argued that the plaintiff had misrepresented the true position of the tenant's suitability. The court held that the facts about the true desirability of the tenant were within the plaintiff's knowledge, 'such as to render that opinion reasonable'. The statement was not a guarantee that the tenant would go on paying rent, but rather an assertion that nothing had occurred in the relations between landlord and tenant which could be considered as making the tenant unsatisfactory. The case of *Fitzpatrick v Michel* (1928) (NSW) produced a similar result.

Statement of intention

A statement of intention, or a promise to do something in the future, does not usually found an action in misrepresentation. In *Civil Service Co-operative Society of Victoria Ltd v Blyth* (1914) (HC), the directors of the defendant (Civil) credit union, who had the power to suspend withdrawals by members, gave an assurance to members, including the plaintiff (Blyth), that they would not exercise this power. The plaintiff pleaded misrepresentation when the defendant subsequently suspended member withdrawals. The court held that the assurance was not a representation of existing fact, but rather a representation of an intention made at that time.

It is possible, however, for a promise to do something in the future to be held as a misrepresentation of a present fact. In *Edgington v Fitzmaurice* (1885) (CA), the plaintiff (Edgington) claimed that he had been induced to invest in a company by the prospectus issued by the directors that included the defendant (Fitzmaurice). The prospectus stipulated that the invested funds would be used for capital and trade improvement. In reality, the directors had always intended to use the funds to discharge existing liabilities. The court held that, while the statement appeared to be one of future intention, it was in truth a misrepresentation of an existing fact, because the defendant (and the other directors) had never intended to use the funds as they had publicly indicated. Similarly, in *British Airways v Taylor* (1976) (HL), the defendant airline, which had overbooked a plane, was prosecuted for making a false statement. It defended the charge on the basis that it was a statement as to a future intention. The court held that the statement was a representation by the defendant that, at the time of booking, there were vacancies on the plane. In other words, it was a statement of present fact.

Representations as to future matters made without reasonable grounds are now actionable as ‘false and misleading’ under the (Cth) Trade Practices Act 1974, s 53, and the equivalent State and Territory Fair Trading legislation.

Statement of law

Parties to a contract are assumed to know the law. In *Eaglesfield v Marquis of Londonderry* (1876) (Ch), Jessel MR noted that, even if a statement of fact incorporated a conclusion of law, ‘that is still a statement of fact and not a statement of law’. The basis for this view is that a party can only ever express an opinion about the law until it is

judicially determined. By contrast, in the case of *Davis Securities Pty Ltd v Commonwealth Bank of Australia* (1992) (HC) (see Chapter 8, p 73), the High Court held that any previous distinction between a mistake of fact or law no longer applied. In view of this decision, it is arguable that the traditional distinction between misrepresentations of fact and law is not as relevant to the High Court, which in a future decision may emphasise whether it was reasonable for the representee to rely upon what the representor said, and whether the representee was deceived as a result of his or her reliance.

Third element (representation is false)

Obviously, the untruthfulness of the representation has to be proved by the facts in each situation.

Fourth element (representation is intended to induce contract)

This element requires that the representation must have been intended by the representor to be acted upon by the representee. In *Peek v Gurney* (1873) (CA), the plaintiff (Peek) purchased existing shares in the defendant's (Gurney's) company, several months after it had issued a favourable prospectus inviting share applications. The prospectus, in reality, contained some wilfully false statements. The plaintiff subsequently sued, alleging that the defendant's statements in the prospectus were a fraudulent misrepresentation. The court disagreed, and held that the purpose of the prospectus was to induce applications for investment in new shares. The plaintiff was not a representee, as he had purchased existing shares several months after the publication of the prospectus. While the purpose of the prospectus was clearly to induce new shareholders to take up un-issued shares, a person, such as the plaintiff, who buys on the open share market, cannot be considered as buying with reference to the defendant's prospectus.

The representation that induces the contract need not be directly made to the representee. A party may qualify as a representee if it can be demonstrated that the representor made the statement with the intention, or with the knowledge, that it would be passed on. In *Commercial Banking Company of Sydney v RH Brown and Co* (1972) (HC), the plaintiff (Brown) entered into a contract to sell wool to a third

party. Before delivery, the plaintiff requested their bank (the former Bank of NSW) to make inquiries about the third party's financial standing. The plaintiff's bank subsequently requested the information from the defendant (CBC), which was the third party's bank, and the defendant reported favourably. In reliance, the plaintiff extended credit to the third party, who then defaulted. In subsequent litigation, the plaintiff argued misrepresentation. The court agreed, because the defendant had known that the information was intended for a customer of the inquiring bank and would, in all likelihood, be acted upon by that customer. It was irrelevant that the information was not given directly to the plaintiff.

Fifth element (representation induced contract)

The representation must actually induce the representee to enter into the contract. The representation need not be the sole inducement, provided it is one of the factors that influenced the representee to enter into the contract. It is not relevant that the representee had the means of discovering the real situation and failed to take up that opportunity. In *Redgrave v Hurd* (1881) (CA), the defendant (Hurd) claimed he was induced to purchase the plaintiff's (Redgrave's) legal practice, following a statement by the plaintiff grossly overstating his yearly earnings. When some discrepancies in the profit forecasts arose, the defendant was given the opportunity of examining some of the plaintiff's financial papers, which he did not take up. When the truth surfaced, the defendant refused to complete and the plaintiff sued for specific performance. The defendant successfully counterclaimed for rescission for misrepresentation. The court held that the defendant's failure to read the plaintiff's financial papers was not a relevant factor. Unless there are exceptional circumstances that would make the representee highly suspicious, the representation, once made, relieves the representee from an investigation of it, even if the opportunity is afforded.

By contrast, in *Attwood v Small* (1838) (HL), the plaintiff (Small) negotiated with the defendant (Attwood) to purchase a mine. During the negotiations, the defendant grossly exaggerated the mine's capabilities and output. The plaintiff commissioned an independent investigation into the defendant's statement and, following a favourable report, proceeded with the purchase. The plaintiff subsequently discovered that the defendant's statement was untrue and sought rescission claiming misrepresentation. The court held that

the plaintiff had not relied upon the defendant's statement, but rather on its own independent investigation. The plaintiff failed to prove that the representation had actually induced the contract.

Categories of misrepresentation

If the five elements for misrepresentation are established, the contract is voidable and the innocent representee generally has the right to rescind it. In addition, the representee may, for certain types of misrepresentation, be entitled to claim damages. The three relevant categories are fraudulent, negligent and innocent misrepresentations.

Fraudulent misrepresentation

A fraudulent misrepresentation is a deliberate misrepresentation made by a representor who had no honest belief in the truth of the statement. In *Derry v Peek* (1889) (HL), the plaintiff (Peek) bought shares in the defendant's (Derry's) tramway company, following a statement in the prospectus that the company was authorised to use steam power instead of horses. Although the company had applied for the necessary authorisation, the statement was untrue because the company was not authorised. Following the rejection of their consent application, the company went into liquidation. The plaintiff sued the defendant and other directors claiming damages for fraudulent misrepresentation. The court ultimately held that the defendant and the other directors were not liable for the statement because, at the time it was published, they honestly believed in the truth of it. The court was not concerned that the defendant had no reasonable grounds for belief in the statement. Lord Herschell made the following comments:

... [First,] in order to sustain an action of deceit there must be proof of fraud and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false ... To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial.

This view was upheld in the case of *Thomas Witter Ltd v TBP Industries Ltd* (1996) (Ch), where Jacob J held that in order to establish fraudulent misrepresentation, it had to be shown that the representor's recklessness in making the false statement was such as to amount to a disregard of the truth, to the extent that the representor should be regarded as having acted fraudulently.

Apart from pleading fraudulent misrepresentation as a defence to an action in specific performance, the representee can seek the following remedies.

Rescission of the contract

A misrepresentation, regardless of the type, renders the contract voidable at the option of the representee. When the right to rescind is lost (see discussion below, p 101) the remaining remedy is damages.

Damages

As the fraudulent representation does not form part of the contract, the representee cannot seek damages for breach. Nevertheless, damages are available in tort for deceit (that is, fraud). In addition, these damages can be claimed even when the representee chooses to affirm, and not rescind, the contract. In *S Gormley and Co Pty Ltd v Cubit* (1964–65) (NSW), the plaintiff (Cubit) was induced by a fraudulent misrepresentation made by the defendant (Gormley) to enter into a contract to purchase a business. The plaintiff, who completed the contract, subsequently sought damages. The court held that the right to seek damages for fraudulent misrepresentation is not lost if the representee elects to affirm the contract.

Negligent misrepresentation

A negligent misrepresentation is made by a representor, who owes a duty of care to a representee, and who has acted carelessly in making the statement. In *Hedley Byrne and Co Ltd v Heller and Partners Ltd* (1964) (HL), the plaintiff's (Hedley's) advertising agency were engaged by a third party to conduct an advertising campaign. As the plaintiff would be required to enter into publishing contracts with the media, it asked its bankers to obtain a credit assessment report from the defendant (Heller), which were the third party's bankers. In response, the defendant provided a favourable report and the plaintiff proceeded with the advertising campaign. The plaintiff later suffered financial loss when the third party went into liquidation. The court found in

favour of the defendant because the report was headed 'Confidential. For your private use and without responsibility on the part of this bank or its officials.' In the court's view, given the circumstances, this statement was an effective disclaimer. However, in *obiter dicta*, the court held that, had there been no such disclaimer, the defendant may have been liable for the tort of negligence (the trial judge did find negligence, but no duty of care). In addition, the court stated that the defendants may have been liable, even though there was no contractual or fiduciary relationship between the parties, and the damage was purely financial.

The *Hedley Byrne* principle was adopted by the High Court in *Mutual Life and Citizens' Assurance Co Ltd v Evatt* (1968) (HC), where Barwick CJ stated that the representee must establish the following elements:

- (a) the representor must be aware that 'he is being trusted to give the best of his information or advice' to the representee;
- (b) the subject matter of the representation, whether information or advice, is of a serious or business nature;
- (c) the representor must realise that the representee intends to act upon the representation;
- (d) it must be reasonable, given the circumstances, for the representee to rely on the representation.

On appeal to the Privy Council, a majority of the court limited the operation of the *Hedley Byrne* principle to commercial situations of advice giving. This narrowing of the principle was in turn rejected by the High Court in *Shaddock, L and Associates Pty Ltd v Parramatta City Council* (1981) (HC). In this case, the plaintiff (Shaddock) proposed to buy land for commercial redevelopment. Before the purchase contract was exchanged, the plaintiffs' solicitor applied for a zoning certificate and road widening inquiry from the defendant (Parramatta). The defendant's then practice was to endorse the zoning certificate as to the existence of any road widening proposals, notwithstanding that it had no legal duty to give such information and did not charge a fee for the endorsement. In the absence of any endorsement, it was usually assumed that no road widening proposal existed. The zoning certificate sent to the plaintiffs' solicitor contained no such endorsement or reference to any road widening proposal affecting the property. The plaintiff completed the purchase, and subsequently discovered that almost half of the property was subject to a road widening proposal, and that this proposal had existed at the time of the inquiry. As it could not proceed with the redevelopment, the plaintiff successfully sued the

defendant for damages on the ground of negligent misrepresentation. The court held that the *Hedley Byrne* principle was not limited to representations made by business or professional persons who possess the appropriate skills and competence. In addition, the principle is not limited to the giving of advice, but includes the giving of factual information. Nevertheless, in determining whether there has been reasonable reliance by the representee on the statement, the court will look at the nature and circumstances of the statement, the skill and expertise (real or purported) of both parties, the foreseeability of reliance by the representor, and the presence or absence of any disclaimer.

As with fraudulent misrepresentation, the representee can raise the misrepresentation as a defence to specific performance, or elect to rescind the contract. In addition, the representee can sue for damages. The basis of the damages remedy lies in the tort of negligence.

Innocent misrepresentation

An innocent misrepresentation is an untrue representation made by a representor, who at the time of making the statement, believed it to be true (and therefore had no intention to mislead), or who was not negligent. In other words, the misrepresentation was made neither fraudulently nor negligently. Apart from raising innocent misrepresentation as a defence to specific performance, the only remedy is rescission. As there is no right to claim damages, a representee who loses the right to rescind the contract has no further remedy.

Rescission for misrepresentation

The object of rescission is to restore the parties to the position they were in before the contract was entered into. Questions arising include:

- (a) how does a representee rescind a contract for misrepresentation?
- (b) is rescission possible if the representation has become a term of the contract?
- (c) are there any limits placed upon the right of rescission?

Rescinding a contract

Rescission takes effect from the date and time of communication by the representee to the representor. It is usually effected by actual communication, but constructive communication, as demonstrated by the actions of the parties, is possible. In *Car and Universal Finance Co Ltd v Caldwell* (1965) (CA), the defendant (Caldwell) sold his Jaguar car to a criminal (Norris). Before the defendant discovered that Norris's cheque had been dishonoured, Norris had sold the car to a motor dealer, who in turn had sold it in good faith to the plaintiff (Finance). In the subsequent litigation, the plaintiff argued that the defendant had not properly given Norris express notice of the rescission of their contract, and as a consequence, Norris had good title to sell the car. The defendant argued that actual communication was not possible because Norris had absconded, and in any event, constructive notice could be implied from the defendant's actions by informing the police and the Automobile Association. The court held that the plaintiff did not get a good title to the car because the actions of the defendant were sufficient, in the circumstances, to constitute a valid rescission.

Rescission if representation a term

A representee can generally elect to rescind a contract notwithstanding that the representation became a term of the contract. A representee cannot, however, simultaneously seek rescission for misrepresentation and sue for damages for a breach of a term of a contract. In *Alati v Kruger* (1955) (HC) (discussed below, p 103), the court stated that the representee 'has a choice ... he might sue for damages for breach of warranty, for the statement formed one of the terms of the contract and was not only a representation ...' but the representee cannot do both. Remember, however, that the representee might be able to sue for damages in tort in either fraud or negligence, depending on how the representation is construed.

Limitations upon rescission

There are five instances where the representee's right to rescind a contract may be lost. They are where:

- (a) the representee has affirmed the contract;
- (b) restitution is impossible;

- (c) an innocent third party has acquired an interest in the subject matter of the contract prior to the purported rescission;
- (d) there has been a lapse of time (that is, delay);
- (e) the contract has been executed.

Affirmation

If a representee elects to affirm a contract, with full knowledge of the facts, the representee cannot subsequently seek to avoid it. In other words, the affirmation, once made, cannot be altered. While the affirmation may be express, or implied by conduct, it must be found to have taken place. In *Long v Lloyd* (1958) (CA), the plaintiff (Long) read an advertisement, placed by the defendant (Lloyd), for the sale of a lorry 'in exceptional condition'. The defendant later repeated the representation in person and offered the plaintiff a test drive that he accepted. As the lorry ran well on the test drive, and following further representations by the defendant as to speed capability and fuel economy, the plaintiff agreed to purchase it. The lorry performed badly in a subsequent trip and, following a complaint by the plaintiff, the defendant offered to contribute to the repair costs, which he did. Shortly thereafter the lorry broke down completely, and the plaintiff sought rescission for (innocent) misrepresentation. The court held that while the test drive did not amount to an affirmation by the plaintiff of the contract, his subsequent conduct (that is, accepting the defendant's offer to contribute to the repair costs, etc) extinguished any right of rescission.

The right to rescind is not lost if the representee did not know that there was such a right. In *Coastal Estates Pty Ltd v Melevende* (1965) (Vic), the plaintiff (Melevende) was induced by a fraudulent misrepresentation to purchase land from the defendant (Coastal). The contract provided for payment by instalments. A few months later, the plaintiff became aware of the truth and sought to renegotiate. Another 18 months elapsed before the plaintiff received advice from a solicitor that he had a right of rescission. During all this time, the plaintiff had continued to meet the instalment payments, and had paid council rates, but he had never entered into possession of the property. The court held that the plaintiff had not affirmed the contract merely by paying the instalments and rates, since he was not aware that he had a right to rescind.

Restitution is impossible

Given that the object of rescission is to restore the parties to their pre-contract positions, an order for rescission was refused at common law

if precise restoration was not possible. In *Clarke v Dickson* (1858) (KB), the plaintiff (Clarke) was induced by the defendant (Dickson, and others) to take up shares in a mining partnership, which converted into a limited liability company three years later. A short time later, the company was wound up. In subsequent litigation, the plaintiff sought to rescind the shares agreement. The court refused to allow rescission because ‘*restitutio in integrum* was impossible’. The shares in the newly formed company were different from the initial shares in the partnership. In other words, as the subject matter of the contract had substantially altered, it was impossible to restore the parties to their pre-contract position.

By contrast, equity was prepared to allow rescission if substantial restitution was possible. In *Alati v Kruger* (1955) (HC), the plaintiff (Kruger) bought a fruit business, including stock-in-trade worth £20, from the defendant (Alati), following a representation that average weekly takings were £100. When the plaintiff discovered that this was a fraudulent misrepresentation, he sought rescission 13 days after entering into the contract. By the time the case reached court some months later, the business had closed and the landlord had re-entered the business. While precise restitution at common law was not possible, the court held that the parties could be restored ‘substantially to the status quo’ by exercise of equitable powers. This included, for example, payment by the plaintiff for stock-in-trade. The fact that the business had deteriorated was not the plaintiff’s fault. A similar approach was taken in *Senarayake v Cheng* (1966) (PC).

Third party rights

The right of rescission by the representee may be lost if an innocent third party has acquired a right in the subject matter of the contract. The third party must have acquired the interest in good faith, without notice of the defective ownership, and for valuable consideration.

Lapse of time

Any delay in seeking rescission is relevant in either of the following situations:

- (a) an inordinate period of time elapses between the making of the statement and the purported rescission; or
- (b) after becoming aware of the misrepresentation, the representee wastes considerable time before seeking to rescind.

In *Leaf v International Galleries* (1950) (CA) (discussed also in Chapter 9, with regard to common mistake), the plaintiff (Leaf) was induced to

purchase a painting from the defendant (Galleries), after it had been innocently misrepresented as an original painting by a famous artist (Constable). Five years later, the plaintiff sought to rescind the contract after he discovered it was a copy. The court refused rescission given the lengthy period of time between the purchase and the purported rescission. The court held that the plaintiff had ample time to have the painting examined for its authenticity. By contrast, in *Leason Pty Ltd v Princes Farm Pty Ltd* (1983) (NSW), the plaintiff (Leason), upon discovering a misrepresentation regarding its purchase of a thoroughbred horse from the defendant (Princes), successfully rescinded nearly nine months after the contract was entered into. The court held that the plaintiff had not been guilty of any undue delay in either having the subject matter examined, nor seeking rescission.

Executed contracts

Rescission may be refused if a contract, which was induced by an innocent misrepresentation (and not a fraudulent or negligent misrepresentation), has been executed (that is, fully performed). In *Seddon v North Eastern Salt Co Ltd* (1905) (Ch), the plaintiff (Seddon) purchased shares in a company following an alleged innocent misrepresentation by the defendant (Salt). The court refused to allow rescission because the contract had been fully executed (for example, the shares had been transferred to the plaintiff and duly registered). In justifying this rule, the court relied on Lord Campbell's statement in *Wilde v Gibson* (1848) (HL), that 'where a conveyance has been executed ... a court of equity will set [it] aside only on the ground of actual fraud'.

Subsequent decisions have modified or distinguished the rule in the *Seddon* case. For example, it was criticised by Lord Denning in *Leaf v International Galleries* (above, p 103), and in *Leason Pty Ltd v Princes Farm Pty Ltd* (also above), Helsham CJ in equity stated that the rule was said by way of *obiter dicta*, and therefore its application was open to question. However, in *Vimig Pty Ltd v Contract Tooling Pty Ltd* (1987) (NSW), Wood J suggested, also by way of *obiter*, that the rule in the *Seddon* case was applicable in Australia, notwithstanding the view expressed in the *Leason* case. In any event, the rule has been abolished in South Australia and the ACT by their misrepresentation legislation (discussed below, p 105). In addition, the rule has been abolished by the (NSW) Sale of Goods Act 1923, s 4(2a) and (b).

Statutory intervention

The Commonwealth, South Australia and the ACT have all enacted legislation to specifically modify the common law rules relating to misrepresentation. In addition, all States and Territories have enacted Fair Trading legislation that mirrors many of the provisions of the (Cth) Trade Practices Act 1974.

(Cth) Trade Practices Act 1974

The Act contains a number of provisions that cover misrepresentation by a corporation engaged in trade or commerce to a consumer: see ss 51A, 52, 53, 53A, 53B, 55, 55A and 59.

The most relevant provision is s 52, which prohibits corporate conduct that is misleading or deceptive to a consumer (or is likely to mislead or deceive). The equivalent sections under the State and Territory Fair Trading legislation are NSW/NT, s 42(1); Vic, s 11; Qld, s 38(1); SA, s 56(1); WA, s 10(1); Tas, s 14(1); ACT, s 12. Section 52 would not only cover situations of misrepresentation at common law, but would arguably cover situations beyond the common law, such as misstatements of opinion, intention or law. If a breach of s 52 is established, the representee may be entitled to seek the following relief under Part VI:

- (a) damages under s 82 – also see NSW, s 68(1); Vic/Tas, s 37(1); Qld, s 99(1); SA, s 84(1); WA, s 79(1); NT, s 91; ACT, s 46;
- (b) or any other relevant order (for example, declaring a contract void, directing a refund of money or return of property, or even varying the contract) under s 87 – also see NSW, s 72; Vic/Tas, s 41; Qld, s 100; SA, s 85; WA, s 77; NT, s 95; ACT, s 89.

(SA) and (ACT) Misrepresentation legislation

Although their importance has been superseded somewhat by the Fair Trading legislation, the relevant statutes are the (SA) Misrepresentation Act 1971 and (ACT) Law Reform (Misrepresentation) Act 1977. The main provisions are as follows:

- (a) the representee may rescind a contract even if the misrepresentation has become a term of the contract: SA, s 6(1); ACT, s 3; and this provision is also found in the (Vic) Goods Act 1958, s 100;

- (b) rescission is not lost merely because the contract has been performed or because documents have been publicly registered (that is, the rule is the *Seddon* case does not apply): SA, s 6(1); ACT, s 3;
- (c) subject to certain statutory defences (for example, the representor's 'honest and reasonable' belief in the truth of the statement), damages are available for innocent misrepresentation: SA, s 7(1); ACT, s 4(1);
- (d) even if the right to rescind a contract is established, the court may award damages in lieu if it believes that this is the appropriate remedy: SA, s 7(3); ACT, s 5(1).

10 Unconscionability

You should be familiar with the following areas:

- the requirements of duress
- the effect of undue influence
- equitable relief for unfair contracts

Introduction

Unconscionability is another vitiating factor that may operate to demonstrate that the parties did not genuinely consent to the formation of a contract. Unconscionability includes duress, undue influence, and unfair contracts.

Duress

Duress is illegitimate pressure exerted by a dominant party to coerce a weaker or subservient party to consent to a contract against that party's will. In other words, the weaker party does not have real freedom to choose whether or not to enter into the contract. Illegitimate pressure must be distinguished from commercial pressure. In *Smith v William Charlick Ltd* (1924) (HC), the plaintiff (Charlick) purchased wheat from the defendant (Smith/Wheat Harvest Board). Following delivery and payment, the defendant demanded additional payment, although not legally entitled. The defendant intimated that if the further payment was not made, future wheat sales were unlikely. The plaintiff paid under protest, because the defendant was the sole wheat supplier in South Australia. In subsequent litigation, the plaintiff alleged duress. The court disagreed, finding that the defendant's actions amounted to commercial pressure, not duress. The

court stated that, although the payment was made 'unwillingly ... it was, nevertheless, paid voluntarily, in the legal sense ... and without any unlawful compulsion, extortion, undue influence, or the abuse of any duty' (cf economic duress, discussed below, p 109).

If duress is proven, the contract is voidable at the option of the weaker party. Rescission will only be possible, however, for the same reasons discussed in Chapter 9 for misrepresentation. In addition, 'harassment and coercion' are prohibited under the (Cth) Trade Practices Act 1974, s 60, and the equivalent State and Territory Fair Trading legislation: NSW/NT, s 55; Vic, s 22; Qld, s 50; SA, s 69; WA, s 23; Tas, s 26; ACT, s 26. A breach of s 60 (and fair trading equivalents) would enable the innocent party to claim a remedy under Part VI; in particular, damages under s 82, or any order under s 87 the court 'thinks appropriate'.

There are three types or categories of duress – duress to the person, duress of goods and economic duress.

Duress to the person

Duress to the person involves actual or threatened violence to, or actual or threatened confinement (that is, imprisonment) of the innocent party coerced, or a close relative or associate of the innocent party. In other words, the act or threat must be both unlawful and directed towards obtaining the innocent party's assent to a contract. In *Barton v Armstrong* (1976) (PC), a trial judge was satisfied that the defendant (Armstrong) had, on a number of occasions, threatened to kill or injure both the plaintiff (Barton) and members of the plaintiff's family. Nevertheless, the trial judge was also satisfied that the plaintiff had entered into several contracts with the defendant for business reasons, in addition to the threats. One of the plaintiff's arguments on appeal was that it was sufficient that the threats had been one reason for the contract, rather than the sole reason. The Privy Council agreed, and decided that duress would operate if the threats were a contributing factor to entering the contract. The onus falls upon the party accused to demonstrate that duress was not a contributing factor in the innocent party's assent.

Duress of goods

Duress of goods involves a situation where one party unlawfully seizes, detains, damages or destroys the goods of the weaker party, or threatens to do so. In *Occidental Worldwide Investment Corp v Skibs A/S*

Avanti (The Siboen and the Sibotre) (1976) (QB), Kerr J stated that if a weaker party:

... should be compelled to sign a ... contract for a nominal but legally sufficient consideration under an imminent threat of having [his] house burnt down or a valuable picture slashed, though without any threat of physical violence to anyone, I do not think that the law would uphold that agreement ... If the contract is void the consideration would be recoverable in quasi-contract [that is, restitution], if it is voidable, equity could rescind the contract and order the return of the consideration.

Economic duress

Economic duress is a more modern legal development. It involves a situation where a threat was made by the dominant party to prejudice the innocent party's economic interests, and that dominant party's threat was made to procure a contract with the innocent party. If proved, this form of duress will render the contract voidable at the option of the innocent party, provided that party's free will to resist the threat was impaired. In *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* (1979) (QB), the defendant (Hyundai), who had agreed to build a ship for the plaintiff (North) for a price fixed in US currency, demanded an increase in the price because of a subsequent devaluation of the US dollar. As the contract did not provide for such an increase, the defendant made it clear that it would terminate the contract unless the plaintiff agreed to pay the increased price. The plaintiff reluctantly paid the increase because it needed the ship urgently to fulfil business commitments. In subsequent litigation, the court stated that the contract was voidable and that the excess money could be recovered for economic duress. However, given delay on the part of the plaintiff, the court refused to rescind the contract.

In *Pao On v Lau Yiu Long* (1980) (PC), Lord Scarman said, in *obiter*, that commercial pressure can render a contract voidable where such had procured the assent of a party to it. His Lordship listed several questions that are relevant to the issue of coercion. Did the innocent party coerced:

- (a) have an alternative course of action available?
- (b) protest?
- (c) have independent advice?
- (d) take steps to avoid the contract?

In *Crescendo Management Pty Ltd v Westpac Banking Corporation* (1988) (NSW), the alleged duress involved an unlawful threat by the defendant (Westpac) to withhold moneys due to one of the two directors of the plaintiff (Crescendo), unless the plaintiff entered into a mortgage. The court held that this was not a situation of economic duress. McHugh JA stated that for economic duress to be established, the court must ask itself whether any applied pressure actually induced the innocent party to enter into the contract, and if so, further ask whether that pressure went beyond what the law is prepared to countenance as legitimate. Pressure will be illegitimate if it consists of unlawful threats or amounts to unconscionable conduct. But overwhelming pressure, not amounting to unconscionable or unlawful conduct, 'will not necessarily constitute economic duress'.

Undue influence

Undue influence takes place where the stronger party influences the will of the weaker party to obtain that party's consent to a contract. The doctrine is derived from equity, and the principle that the stronger party should not be allowed to enjoy the profits of a fraud or other wrongful act. Unlike duress, it need not involve an unlawful act.

Where undue influence is established, and has led to the obtaining of a benefit by the stronger party, the contract or other transaction is voidable at the option of the weaker party. Alternatively, undue influence can be used as a defence to an action for specific performance. As with misrepresentation and duress, rescission will only be approved subject to certain conditions; in particular, the requirement that the parties be restored to their pre-contract position. In addition, undue influence may amount to a claim of 'misleading and deceptive conduct' under the (Cth) Trade Practices Act 1974, s 52 (and Fair Trading equivalents), and a breach would enable the weaker party to claim a remedy under Part VI; in particular, damages under s 82, or any order under s 87 the court 'thinks appropriate'.

There are two distinct categories of undue influence – presumed undue influence and actual undue influence.

Presumed undue influence

In certain situations involving a contract between parties in a fiduciary relationship, undue influence will be presumed. The consequence is

that the stronger party bears the burden of proving the absence of pressure. In other words, in certain special relationships there is a rebuttable presumption of influence in favour of the stronger party.

Recognised special relationships include:

- (a) parent and child;
- (b) trustee and beneficiary;
- (c) solicitor and client;
- (d) doctor and patient;
- (e) religious adviser and disciple.

Where the special relationship does not fall within one of the recognised categories, the weaker party will bear the burden of proving either, that the antecedent relationship was of the type that undue influence should, as a matter of law, be presumed; or alternatively, there was actual undue influence (see below, p 112). In *Johnson v Buttress* (1936) (HC), the elderly father of the plaintiff (Buttress) gave away his cottage to the defendant (Johnson). At the time of the gift, the evidence established that the old man was illiterate, recently widowed, had little commercial experience, and was heavily dependent on the defendant for advice, comfort and friendship. Following the old man's death, the plaintiff sought to have the contract rescinded for undue influence. The court held that as the relationship between the parties was one of total trust and dependence, this was sufficient to create a presumption of undue influence. As the defendant was unable to rebut the presumption, the gift was set aside. A similar view was expressed in *Barclays Bank plc v O'Brien* (1994) (HL).

The lack of independent advice to the weaker party, before signing the contract, is highly relevant. In *Lloyds Bank Ltd v Bundy* (1975) (CA), the defendant (Bundy), an elderly man whose major asset was his farm, was a customer of the plaintiff (Lloyds), as was his son. Following financial problems incurred by the son's company, the defendant guaranteed the company's overdraft and charged his farm as security for a loan by the plaintiff to the son's company. The defendant did so following the personal advice of the defendant's local assistant manager, given on several different occasions. The plaintiff subsequently took action against the defendant when the son's company went into receivership. The court held that, in the circumstances, there existed a special relationship between the defendant and the plaintiff that imposed upon the plaintiff a fiduciary duty to ensure that the defendant formed an independent and informed judgment, before committing to the proposed contract. In

other words, the bank should have advised the customer to obtain independent advice before signing the loan documents.

The stronger party may rebut the presumption of influence by showing that:

- (a) full disclosure of all material facts was made;
- (b) the consideration was adequate;
- (c) the weaker party received independent advice.

Actual undue influence

Where no special relationship exists, the burden rests on the weaker party to establish that:

- (a) there was an appropriately influential relationship;
- (b) that the stronger party exercised undue influence to secure an unfair advantage;
- (c) that the undue influence motivated the weaker party to enter into the contract;
- (d) that the weaker party acted promptly in purporting to avoid the contract.

In *Allcard v Skinner* (1887) (CA), the plaintiff (Allcard) entered a convent as a novice and took the vows of poverty, obedience and chastity. Without independent advice, she gave all her property to the defendant (Skinner), the mother superior of the convent. Six years after leaving the order, the plaintiff sought the return of some of the property. The court held that there was a right of rescission because of actual undue influence. However, rescission was not granted because the plaintiff had not acted within a reasonable time, despite receiving some legal advice not long after she had left the convent.

Unfair contracts

The common law and equity differ on the issue of allowing a weaker party to escape an unfair contract simply because of an inequality of bargaining power. While the common law will not set aside an unfair or unconscionable contract, equity may grant relief to a party under a special disadvantage, provided the stronger party is aware of it. In *Blomley v Ryan* (1956) (HC), Fullagar J listed 'poverty ... need ...

sickness, age, infirmity of body or mind, drunkenness, illiteracy ... lack of assistance or explanation where assistance or explanation is necessary' as examples of parties under special disadvantage.

If unconscionable conduct is pleaded, the onus of proof rests with the disadvantaged party. If the special disadvantage is established, the onus shifts to the stronger party to demonstrate that the contract was fair and reasonable. In *Lloyds Bank Ltd v Bundy* (1975) (CA) (see above, p 111), Lord Denning MR held that the common 'single thread' that runs through all cases of duress, undue influence and unfair contracts, is 'inequality of bargaining power'; and, if established, relief will be given:

... to one who, without independent advice, enters into a contract upon terms which are very unfair, or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired ... I do not mean to suggest that the principle depends on proof of any wrongdoing. The one who stipulates for an unfair advantage may be moved solely by his own self-interest, unconscious of the distress he is bringing to the other.

Subject to statutory intervention (discussed below, p 116), where a contract is found to be unconscionable, it is voidable at the option of the disadvantaged party, or it can be used as a defence to the claim for specific performance. As with misrepresentation, duress and undue influence, rescission will only be approved subject to certain conditions, in particular, the requirement that the parties be able to be restored to their pre-contractual position.

Knowledge of the special disadvantage

The unconscionable circumstances need not disclose dishonesty or moral obliquity by the stronger party. The stronger party must, however, have actual or constructive knowledge of the disability or special disadvantage of the weaker party. In *Commercial Bank of Australia Limited v Amadio* (1983) (HC), the defendant's (Amadio's) son was a builder whose company was indebted to the plaintiff (Commercial). When it became obvious to the plaintiff's branch manager that the son's company was insolvent, the pair began selectively to dishonour cheques in an effort to give the impression that the son's company was still prosperous. When the plaintiff requested further security, the son asked the defendants to mortgage a property owned by them. The son had led his parents, who spoke and

understood little English, to believe that the mortgage guarantee was limited to \$50,000 and was to be granted for a period of only six months. Just prior to execution, the plaintiff's branch manager informed the defendants that the mortgage guarantee was not limited to six months, but he did not explain to them that the loan was not limited to \$50,000, nor reveal the true financial position of the son's company. The defendants did not receive any independent advice prior to executing the relevant documents. The court held, by majority, that the defendants had been under a special disability when they executed the relevant documentation, and that the plaintiff's awareness of this fact rendered its conduct unconscionable. In his judgment, Deane J commented on the differences between undue influence and unfair dealing:

... undue influence, like common law duress, looks to the quality of the consent or assent of the weaker party ... Unconscionable dealing looks to the conduct of the stronger party in attempting to enforce, or retain the benefit of, a dealing with a person under a special disability, in circumstances where it is not consistent with equity or good conscience that he should do so.

Special equity in favour of married women

In *Yerkey v Jones* (1939) (HC), the issue was whether it was unconscionable to enforce a guarantee given by a wife (Jones) in favour of the debts of her husband's company, in circumstances where she did not understand the nature and effect of the transaction. Dixon J (in giving the leading judgment) laid down the relevant rule as follows:

... if a married woman's consent to become a surety for her husband's debt is procured by the husband, and without understanding its effect in essential respects she executes an instrument of suretyship, which the creditor accepts without dealing directly with her personally, she has a *prima facie* right to have it set aside.

In other words, the decision is important because it set up a special equity in favour of a married woman who supplies a guarantee for the debts of her husband. Nevertheless, on the facts of the case, the court held that the wife could not have the guarantee contract set aside because:

- (a) the guarantee was not procured through deception or other improper acts of the husband;
- (b) an explanation had been provided by a third party; and
- (c) she was in a position to benefit from the transaction.

In *Garcia v National Australia Bank* (1998) (HC), the High Court (*per* Gaudron, McHugh, Gummow, Hayne and Callinan JJ) affirmed the principles of *Yerkey*, and that the married woman's equity remains separate from general unconscionability. The majority found that the married woman's equity depended on the following factors:

- (a) the surety (being a volunteer) is mistaken about the purport and effect of the transaction;
- (b) the creditor should have appreciated (that is, have actual or constructive knowledge) that, because of the trust and confidence between the surety and the debtor (for example, the wife relying on her husband in business matters), the debtor may not have given a sufficient explanation;
- (c) the creditor's actions are unconscionable in the circumstances.

In this case, the court held that the mortgage was unconscionable given the applicability of the relevant factors.

Kirby J agreed with the orders of the joint judgment, but did not agree with the endorsement of the *Yerkey* principle, in particular, that special status should be given to married women. He sought to put forward a reformulation of the unconscionability principle: that where there was emotional dependency created by any long term relationship, the credit provider was obligated to advise the surety to obtain independent legal advice.

Statutory intervention

Several statutes give the court power to deal with situations of unfair or unconscionable contracts:

(Cth) Trade Practices Act 1974

Part IVA prohibits a corporation from engaging in unconscionable conduct. While s 51AA contains the general prohibition, s 51AB sets out the considerations that a court may have regard to. The equivalent provisions in the State and Territory Fair Trading legislation are NSW/NT, s 43; Vic, s 11A; Qld, s 39; SA, s 57; WA, s 11; Tas, s 15; ACT, s 13. The five considerations in s 51AB are:

- (a) the relative bargaining strengths of the corporation and the consumer;
- (b) whether the corporation required the consumer to comply with conditions not reasonably necessary to protect the corporation's legitimate interests;
- (c) the consumer's degree of understanding of the relevant documentation;
- (d) whether the consumer was subjected to any undue influence or pressure by the corporation (or corporation's agent);
- (e) the amount and circumstances under which equivalent goods or services could be acquired elsewhere.

In addition, s 51AC prohibits a corporation, in connection with the supply or possible supply of goods and services to a person, or the acquisition or possible acquisition of goods and services from a person, from engaging in unconscionable conduct. This section only applies to transactions involving goods or services priced below \$1 m and it excludes listed public companies having the benefit of this section. Section 51AC provides a comprehensive list of factors the court may look at to determine the issue of unconscionability. It includes many of the same types as under s 51AB, but also includes compliance with 'industry codes' (also note Part IVB) and acting 'in good faith': see s 51AC(4)(a)–(k).

A breach of Part IVA would enable the consumer to claim a remedy under Part VI; in particular, damages under s 82, or any order under s 87 the court 'thinks appropriate'.

(NSW) Contracts Review Act 1980

This Act gives a court in NSW broad powers to review an unjust contract. An unjust contract is defined as including an 'unconscionable, harsh or oppressive' contract: see s 4(1). Section 9 sets out the matters the court must have regard to in determining whether a contract (or a provision of a contract) is unjust. It is worth noting that the relevant factors which the court must consider in s 9 are broader than under the (Cth) Trade Practices Act 1974.

If a contract (or provision) is found to be unjust, s 7 allows the court, provided 'it considers it just to do so', to do one or more of the following:

- (a) refuse to enforce any or all of the provisions of the contract;
- (b) declare the contract void, in whole or in part;
- (c) vary, in whole or in part, any provision in the contract.

Section 8 allows the court to grant ancillary relief that is set out in Sched 1 of the Act. In addition, s 14 allows the court to grant relief notwithstanding that a contract has been fully executed.

Note: in addition, the (NSW) Industrial Relations Act 1996 contains provisions that enable relief for unfair or unconscionable employment contracts: see ss 106 and 107.

11 Illegality

You should be familiar with the following areas:

- contracts that are illegal or void at common law
- contracts that are illegal or void at statute
- consequences of an illegal contract
- consequences of a void contract
- doctrine of severance

Introduction

The law may invalidate a contract that it considers has an unlawful or improper purpose. This principle is known as *ex turpi causa non oritur actio* (that is, a court will not allow a party to base a cause of action upon an illegal act). The law may declare a contract illegal and unenforceable. Alternatively, the law may declare a contract void as against public policy (that is, against the best interests of the general community). There are four possible outcomes:

- (a) the contract is entirely void;
- (b) a term of the contract is void (that is, only the term is void – the whole contract is void only if the term is not severable);
- (c) the contract is void only in certain circumstances (for example, as against the Australian Taxation Office);
- (d) the contract is not void but is unenforceable, either in whole or in part (subject to the rights of an innocent third party).

The difference depends upon whether the contract (or a term of the contract) offends the common law or statute.

Contracts illegal at common law

The common law has a long tradition of invalidating certain contracts that are believed to be contrary to the social or economic interests of the wider community. In other words, public policy considerations may outweigh the usual right of parties to contract as they wish. Public policy or public interest will vary over time, given changes in community standards. In addition, the modern common law courts are more reluctant to create new areas of contract illegality due to public policy, preferring to rely upon Parliament to do this.

There are six categories of contracts that are illegal and unenforceable at common law on the grounds of public policy. They are contracts:

- (a) to commit crimes and torts;
- (b) to defraud the revenue;
- (c) to promote sexual immorality;
- (d) to promote corruption in public life;
- (e) to prejudice the administration of justice;
- (f) to prejudice foreign relations or public safety.

Contracts to commit crimes or torts

In determining this issue, the court will analyse the central purpose of the contract and the seriousness of the wrongdoing. Obviously, the central purpose must be to commit a crime or a tort (which may include fraud). In *Neal v Ayers* (1940) (HC), the plaintiff (Neal) purchased the defendant's (Ayers') hotel, following a representation that only between 15% and 20% of the weekly sales came from after-hours trading (in contravention of statute). In reality, some 40% of the weekly sales came from illegal trading. In a subsequent action for deceit, the defendant argued that the contract was illegal and unenforceable. The court disagreed, and held that the real purpose or object of the contract was to sell a hotel in the ordinary course of business. The court was satisfied that the plaintiff did not purchase the hotel in order to break the law, even though she admitted that some after-hours trading was contemplated.

Contracts to defraud the revenue

As with the previous category, the central purpose of the contract must be to defraud the revenue. In *Alexander v Rayson* (1936) (CA), the plaintiff (Alexander) leased a flat to the defendant (Rayson) for the yearly rent of £1,200. In order to be eligible for lower council rates, the plaintiff sought to hide the actual value of the lease by using two contracts: one dealing with the actual lease of the property (upon which the rates would be levied), and a second contract for services rendered in connection with the property (which would not be subject to rates). The plan was ultimately unsuccessful and full council rates were levied. In a subsequent dispute between the parties, the issue was whether the plaintiff could enforce the contract. The court held that the lease contracts were illegal and unenforceable because the plaintiff had clearly attempted in the contracts to defraud the local council of revenue.

Contracts promoting sexual immorality

This category has weakened in importance as the general community has reconsidered its views on sexual matters. Contracts that directly or indirectly involved prostitution were usually held to be illegal and unenforceable. In *Upfill v Wright* (1911) (KB), the plaintiff (Wright) rented a flat to the defendant (Upfill), knowing that it was going to be used for prostitution. A later action to recover arrears of rent failed because the court held that the contract was illegal and unenforceable. The court was satisfied that while the lease itself was legal, the plaintiff knew that the contract promoted a sexually immoral purpose.

Historically, cohabitation contracts between *de facto* spouses were held to be illegal and unenforceable. Given shifts in community opinion, this view no longer applies: see *Andrews v Parker* (1973) (Qld). Notwithstanding any common law rule of public policy, cohabitation and/or separation agreements between *de facto* spouses are now regulated by statute in all states and territories except Victoria and Western Australia:

- (a) (NSW) Property (Relationships) Act 1984, Part IV, ss 44–52;
- (b) (Qld) Property Law Act 1974, Division 3, ss 269–78;
- (c) (SA) De Facto Relationships Act 1996, Part 2, ss 5–8;
- (d) (Tas) De Facto Relationships Act 1999, Part 4, ss 36–41;
- (e) (NT) De Facto Relationships Act 1991, Part 3, ss 44–50;
- (f) (ACT) Domestic Relationships Act 1994, Part IV, ss 31–37.

The legislative provisions in NSW, Queensland and the ACT also apply to cohabitation and separation agreements made between same-sex partners. In Victoria, despite the lack of any legislative provision for the *de facto* partners to enter into a certified or judicially approved cohabitation or separation agreement, a court is still required to consider 'any written agreement entered into by the *de facto* partners' before making a 'just and equitable' property adjustment order: see (Vic) Property Law Act 1958, s 285.

Contracts promoting corruption in public life

This category comprises contracts that are prejudicial to the administration of the affairs of the State or nation. This prohibition includes contracts for the buying or selling of political offices, government contracts or public awards. In *Wilkinson v Osborne* (1915) (HC), the plaintiffs (Osborne and Jones), who were NSW Members of Parliament, agreed to lobby for the completion of a government transaction involving the defendant's (Wilkinson's) principal, in return for a promised payment of £250. The transaction was subsequently completed, but the promised payment was not made. The court held, not surprisingly, that the payment was not recoverable, as it was based on an illegality. A similar result occurred in *Parkinson v College of Ambulance Ltd and Harrison* (1925) (KB) (discussed above, Chapter 4), where a contract for the promise of a knighthood in return for a £3,000 donation was found to be illegal and unenforceable.

Contracts prejudicial to the administration of justice

This category comprises contracts to conceal offences, or compromise criminal prosecutions or the proper administration of justice. In *Keir v Leeman* (1846) (QB), the plaintiff (Keir) had commenced a prosecution for assault against several third parties. Prior to the hearing, the plaintiff entered into a contract with the defendant (Leeman), whereby the plaintiff would be paid in return for not proceeding with the prosecution. The plaintiff subsequently gave no evidence at the trial and the third parties were acquitted. The defendant later refused to pay, and the plaintiff's action to enforce the contract was unsuccessful because it was illegal and unenforceable. Compromising a civil action is not illegal. However, a party may commit the tort of maintenance by encouraging another to bring a civil action. In addition, a party (for example, a lawyer, and subject to State and Territory Legal Profession

legislation, which may allow contingency costing contracts) who enters into a contract to be paid a share of litigation proceeds may commit the tort of champerty.

Contracts prejudicial to foreign relations or public safety

This category involves two types of contract:

- (a) contracts which tend to benefit an enemy country, or which may seriously affect national security and safety;
- (b) contracts which could jeopardise or disturb the existing good relations with another country.

In *Regazzoni v KC Sethia (1944) Ltd* (1958) (HL), the plaintiff (Regazzoni) entered into a contract in England to buy a large quantity of Indian jute bags from the defendant (Sethia). The defendant knew that the plaintiff intended to export the bags to South Africa, and both parties knew that under the then Indian law, it was illegal to export jute to South Africa. In subsequent litigation, the court held that the contract was illegal and unenforceable, because both parties had intended to contravene the laws of a friendly country, India.

Contracts void at common law

There are three categories of contract that are void at common law on public policy grounds:

- (a) contracts to oust the jurisdiction of the courts;
- (b) contracts that prejudice the status of marriage;
- (c) contracts in restraint of trade.

While these contracts offend public policy, the common law views them as less offensive than contracts that are illegal and unenforceable.

Contracts to oust the jurisdiction of the courts

A valid contract cannot include a term denying a party's right to enforce it. If such a term is included it is void, as it would offend public policy, because it is the right of the courts to determine contractual disputes. This rule does not affect a term that provides for alternative dispute resolution (as discussed in Chapter 6). Arbitration clauses may

be included in a contract provided they do not completely oust the jurisdiction of the courts. In other words, such clauses may provide that arbitration must be attempted in the first place. This exception was recognised in *Scott v Avery* (1856) (HL), where Lord Campbell stated that the effect of the clause is that no cause of action arises until after the arbitration has taken place. Commercial arbitration contracts are now governed by uniform State and Territory Commercial Arbitration legislation. The legislation provides that an arbitration clause cannot prevent legal proceedings being brought prior to arbitration taking place: see s 55. However, the legislation also allows a court to stay legal proceedings until arbitration has been attempted: see s 53.

Contracts prejudicial to the status of marriage

The sanctity of marriage is a matter of public interest. Contracts which restrict the freedom of a person to marry, or which purport to prejudice the stability of a marriage, are void as against public policy. Contracts entered into between married spouses are now regulated by statute: see (Cth) Family Law Act 1975, Part VIIIA, s 90A–L. This Act was amended in 2000 to enshrine the right of a married couple to enter into a certified ‘binding financial agreement’, whether before or during the marriage, or following separation or divorce. Each party must be independently advised by a legal practitioner prior to signature for the agreement to become binding.

Contracts in restraint of trade

Courts have always been reluctant to enforce a contract whereby one party agrees with another party to restrict future trade, or the type of work that can be undertaken. This is because these contracts have the potential to restrict the personal liberty of, and deprive society of the skills and benefits of, the party agreeing to the restraint of trade. However, not all restraint of trade contracts (or clauses in contracts) are void for public policy. Certain restraint of trade contracts may be justified as being in the interest of the contracting parties, and of the public. In *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* (1894) (HL) (discussed below, p 126), Lord Macnaughten stressed that if the restriction was reasonable it may be held to be a valid restraint of trade. The reasonableness of the restraint is ascertained by three factors:

- (a) reasonable in relation to the interests of the parties to the contract;
- (b) reasonable in relation to the interests of the public;
- (c) it must not be injurious to the public.

In other words, a restraint of trade is *prima facie* void as being contrary to public policy, unless it is perceived as being reasonable.

The three common categories of restraints of trade are:

- (a) contracts to regulate trade;
- (b) contracts for the sale of businesses;
- (c) personal service contracts.

Regulate trade

In *Esso Petroleum Ltd v Harper's Garage (Stourport) Ltd* (1968) (HL), the plaintiff (Esso) entered into a contract with the defendant (Harper's) whereby the defendant agreed, in return for a payment, that it would only sell the plaintiff's products at its two garages. The restrictive covenant was four years and five months for the first garage, and 21 years for the second garage. The court held the restraint for the first garage was valid, but the second was unreasonable because of its length. In assessing reasonableness, the court noted the following:

- (a) the onus of establishing reasonableness was on the party benefiting from the restriction (that is, the plaintiff), but the onus should be easily discharged when free and competent parties agree;
- (b) there was some commercial justification for both parties to enter into the contract, in particular, the plaintiff had invested in building refineries and needed a guarantee as to market;
- (c) there was no obvious injury to the community.

In *Amoco Australia Pty Ltd v Rocca Bros Engineering Pty Ltd* (1973) (HC), the defendant (Rocca) agreed with the plaintiff (Amoco) that it would build a service station and lease it to the plaintiff for 15 years. The plaintiff then agreed to sub-lease the service station back to the defendant. The rent was indirectly based upon the volume of petrol sales. The sub-lease contained a covenant by the defendant that it would buy a minimum amount of petrol and oil each month from the plaintiff, and not to buy petrol and oil from anyone else. Following a dispute between the parties, the plaintiff sought an injunction to restrain the defendant from buying petrol and oil from alternative suppliers. The court refused, and held that the restraint was unreasonable, primarily because the 15 year exclusive dealing clause was too long. Gibbs J stated that there was no evidence that the length of the restraint 'was necessary to ensure for Amoco the stable outlet and economical distribution at which it was entitled to aim'.

This area is now regulated, to a large extent by the (Cth) Trade Practices Act 1974. Nevertheless, s 4M provides that the common law doctrine of restraint of trade is unaffected by the Act.

Sale of businesses

When a party buys a business, it is, in most cases, buying the goodwill that was built up by the current and former proprietors. While the price paid for the business will include fittings, fixtures and stock-in-trade, it is the goodwill that the purchaser wishes to maintain in order to keep the business profitable. If the vendor of the business were able to compete for customers in the same area, then it is likely that the purchaser would get nothing for the consideration paid for the vendor's goodwill. This view was expressed in *Butt v Long* (1953) (HC).

In assessing the reasonableness of the restraint of trade, the courts will look at:

- (a) the area of restraint;
- (b) the duration of restraint;
- (c) the type of business;
- (d) the specific wording of the restraint.

In *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* (1894) (HL), the defendant (Nordenfelt) sold his munitions business to a third party for £287,500 and entered into a further contract restraining his future activities. When the third party subsequently amalgamated with the plaintiff (Maxim), the defendant was engaged as managing director on an annual salary of £2,000. The defendant also entered into a further contract with the plaintiff which continued the earlier restraint of trade. Essentially, he agreed that for a period of 25 years he would not carry on any business (except with the plaintiff) or be involved in any other businesses that competed with, or were liable to compete with the plaintiff for business. The area of the restraint included Europe and North America. In subsequent litigation, the court held all but the last part of the restraint of trade clause was valid. In other words, restraining the defendant from carrying on a business in competition with the plaintiff was reasonable to protect their business interests, notwithstanding the length and area of the restraint. However, restraining the defendant from being involved in any other businesses that competed with, or were liable to compete with the plaintiff, was unreasonable since it was wider than was reasonably necessary to protect the goodwill that the plaintiff had acquired.

Personal service

Employment contracts often include a provision that restricts the right of an employee, when the employment terminates, to professionally practise or trade for a stipulated time in a defined area. Traditionally, the courts have frowned upon such restraints believing that the public interest requires that individuals should be free to engage in employment or practice their profession. More importantly, such a restraint is usually not in the best interests of the individual being restrained. In addition to common law relief, an employee may be able to argue that the restraint is unreasonable under Federal, State and Territory Industrial Relations legislation.

An important factor in determining the reasonableness of a service restraint is the relative bargaining power of the parties. In *Schroeder (A) Music Publishing Co Ltd v Macaulay* (1974) (HL), the defendant (Schroeder) employed the plaintiff (Macaulay) as a songwriter for a period of five years (with an option for a further five years), although the defendant could terminate the plaintiff's employment upon giving one month's notice and, in addition, could assign the benefit of the contract to a third party. The contract also provided that all copyright in the plaintiff's work vested in the defendant, and the plaintiff would receive a fixed share of the publishing royalties, although the defendant was under no obligation to publish the plaintiff's work. The plaintiff subsequently argued that the contract was void for being an unnecessary restraint of trade. The court agreed, not just because the length of the restraint was too long, and the clause went beyond what was necessary to protect the defendant's legitimate interests, but also because the plaintiff's bargaining power was weak and he had been exploited. Nevertheless, the evidence of the exploitation must be overt.

There are two common restraints on employees that may be acceptable:

- (a) protection of trade secrets or confidential business information;
- (b) protection of the employer's trade or consumer connections.

In *Forster and Sons Ltd v Suggett* (1918) (Ch), the defendant (Suggett) entered into an employment contract with the plaintiff (Forster) containing a clause restraining him from working (or carrying on a business) in the glass manufacturing industry in the UK for a period of five years after termination. During the course of his employment, the defendant acquired knowledge of a particular glass manufacturing method. In the ensuing litigation, the court upheld the validity of the

restraint of trade clause as a reasonable protection of the plaintiff's trade secret.

In *Fitch v Dewes* (1921) (HL), the plaintiff (Dewes), a solicitor who practised in an English country town, employed the defendant (Fitch) as an articled clerk. A term of the service contract provided that when the defendant ceased his employment, he would not practise as a solicitor within seven miles (11.5 kilometres) of the local town hall. The court held that the restraint was enforceable because it was necessary to prevent the defendant improperly using confidential information acquired during his employment with the plaintiff. By contrast, in *Drake Personnel Ltd v Beddison* (1979) (Vic), the plaintiff (Drake), an employment agency, entered into a service contract with the defendant (Beddison), which included a provision that, upon termination and for a period of 12 months, he would not conduct a similar business within 25 miles (40 kilometres) of the defendant's place of business. When the defendant subsequently breached the restraint of trade clause, the plaintiff sought an injunction. The plaintiff argued that the restraint was necessary to prevent the defendant using trade secrets and confidential information acquired during the course of his employment. The trade secrets included production targets, advertising plans and methods of dealing with clients. The confidential information related to information supplied by clients and to mailing lists. The court refused to grant an injunction and held that the provision was an unreasonable restraint of trade. In relation to the trade secrets argument, the court indicated that the secrets referred to were not of the type for which the courts would normally grant protection. In relation to the mailing lists, the court noted that only 30% of those on the lists were actual clients, the remainder being potential or former clients. In other words, the restraint would have operated to prevent competition for the services of the remaining 70% named in the lists.

Contracts illegal by statute

A contract that is prohibited by statute is also illegal and unenforceable. This is determined by the intention of the statute. To determine the relevant intention, a court will use the rules of statutory interpretation. As a general approach, the court will assess the seriousness of the contravention of the statute, and in particular whether the contravention is central to, or merely incidental to, the

performance of the contract. The illegality may be expressed or implied in the statute. In addition, the statute may render the contract either:

- (a) illegal as formed – the illegality operates at the time of the formation of the contract;
- (b) illegal as performed – while the contract is legal at the time of formation, a factor associated with the performance of the contract renders the contract illegal.

Express prohibition

A statute may expressly declare that a contract made in contravention is illegal and unenforceable. In *Re Mahmoud and Ispahani* (1921) (CA), an order made under the (UK) Defence of the Realm Regulations provided that 'a person shall not buy or sell ... any [linseed oil] except under and in accordance with the terms of a licence'. The plaintiff (Mahmoud), who had a seller's licence, entered into a contract to sell linseed oil to the defendant (Ispahani) whom the plaintiff believed was licensed to purchase the goods. Subsequently, the defendant refused to accept the goods and argued that, as he did not have the required licence, the statute prohibited the contract, and therefore it was unenforceable by the plaintiff. In determining this issue, the court decided that the intention of Parliament was to absolutely prohibit contracts between unlicensed parties. It held that the contract was unenforceable for illegality.

Implied prohibition

There are several factors that may influence the decision of a court. These include ascertaining and analysing the:

- (a) primary aim of the statute and the penalty imposed for contravention;
- (b) innocence of the parties;
- (c) commercial consequences of finding a contract illegal and unenforceable, and in doing so, whether the contravention was central or collateral to the performance of the contract.

Primary aim of statute

Where a statute only stipulates a penalty for breach, and does not indicate the consequences of such a contravention, the court will have to ascertain its primary purpose and effect. Obviously, the outcome may be influenced by the severity of the penalty.

If the primary purpose of the legislation is public safety or public interest, a contravention is likely to render the contract illegal and unenforceable. In *Anderson Ltd v Daniel* (1924) (CA), the plaintiff (Daniel) sold fertiliser to the defendant (Anderson). A statute provided that every sale of artificial fertiliser had to be accompanied by an invoice that clearly stipulated chemical compositions in percentage terms. The statute merely provided a penalty for breach. In the ensuing litigation, the court held that the contract was illegal and unenforceable. The court found that, given the specific nature of the contracts covered by the statute, Parliament intended that such contracts be invalidated for misperformance.

If the primary aim of legislation is simply to raise revenue, a contravention should not invalidate any contract made. In *Smith v Mawhood* (1845) (Ex), the plaintiff (Smith) sold tobacco to the defendant (Mawhood). A statute imposed a penalty of £200 for the sale of tobacco by unlicensed vendors. The plaintiff was unlicensed. The defendant subsequently refused to pay for the tobacco on the basis that the contract was illegal and unenforceable. His defence failed. The court held that the object of the statute was not to prohibit sale contracts by unlicensed traders, but 'merely for the purpose of revenue'. A different view may result today, given the public health debate over tobacco products.

Innocence of the parties

The enforceability or otherwise of the contract will be influenced if there is evidence that one or both of the parties were aware of the contravention at the time they entered into the contract. In *Buckland v Massey* (1985) (Qld), the plaintiff (Buckland) sold a car to the defendant (Massey) without the required roadworthiness certificate. The relevant statute prohibited the sale of a second hand car without the required certificate and imposed a penalty of \$500. The plaintiff received part payment for the car and handed over possession of the car to the defendant. It was further agreed that the defendant would obtain the required certificate (that is, in contravention of the statute). The plaintiff subsequently sued when the defendant refused to pay over the balance of the purchase price. The court held that, as the

contract was unlawful from its inception, it was illegal and unenforceable. Carter J stated that a contract, 'the performance of which contemplates an express prohibition contained in that scheme, is impliedly prohibited by the statute and is unenforceable'.

Commercial convenience

A contract may not necessarily be invalidated for a relatively minor transgression where commercial inconvenience would result. In other words, the contravention must be substantial before a court may declare the contract illegal. In *St John Shipping Corporation v Joseph Rank Ltd* (1957) (QB), the plaintiff (St John) agreed to charter its ship to carry the defendant's (Rank's) cargo. During the course of the voyage, the ship became overloaded in breach of a statutory provision. Upon arrival, the defendant refused to pay the full cost of the freight, arguing that the contract was illegal and unenforceable. The court held the contract was enforceable and not illegal. The contravention had neither been intended nor required for the contract to be performed. While the plaintiff could be fined for breach, the contract was unaffected. In other words, because the illegality was a collateral, and not a central feature of the contract, the contract was not illegal.

In *Dalgety and New Zealand Loan Ltd v C Imeson Pty Ltd* (1964) (NSW), a statutory provision made it an offence to sell a diseased animal for human consumption. The prescribed penalty for breach was £20. The plaintiff (Dalgety), by auction, sold the defendant (Imeson) a cow that, it was later discovered, was suffering from tuberculosis. In subsequent litigation, the defendant argued that the sale was unenforceable for statutory illegality. The court disagreed and held that the statute was intended only to apply a discretionary penalty for breach, and not to render a contract illegal. The relevant considerations were the innocence of the parties, and the fact that it would not have been possible to ascertain the disease without slaughtering the cow. In other words, if the statute were interpreted to render such contracts illegal and unenforceable, it would produce considerable commercial uncertainty.

In *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd* (1978) (HC), the plaintiff (Chicago) entered into a loan contract with the defendant company (Yango) secured by a mortgage on certain land, and a guarantee by third parties (also defendants). When the defendant company defaulted, the plaintiff sought to recover from the other defendants under the guarantee. In their defence, it was argued that the loan contract and guarantee were illegal and unenforceable

because they contravened a provision of the (Cth) Banking Act 1959. Section 8 of the statute prohibited the carrying on of 'banking business' without being authorised. It also stipulated a penalty of \$10,000 for each day during which the contravention continued. The court held that, notwithstanding the fact that the plaintiff was in contravention of the statute, the breach did not render the loan contract and guarantee illegal and unenforceable. The court found that the relevant section did not expressly or impliedly prohibit the contract being made. In particular, Gibbs ACJ noted the following:

[If the statute invalidated contracts, then] persons who had deposited money with [an unauthorised institution] would be unable to seek the assistance of the courts to recover it. Moreover, if [an unauthorised institution] were unable to recover money that it had lent, it would be disabled from performing its own obligations, including those owed to its depositors.

In other words, a finding of illegality would have resulted in considerable commercial uncertainty. Gibbs ACJ also noted that:

... the penalty imposed by the relevant section was calculated on the number of days the contravention continued, and not on the number of transactions made. This was a clear indication that Parliament was more concerned with preventing unlicensed dealings than with prohibiting each contract which resulted from that dealing.

The Yango case was followed in *Farrow Mortgage Security Pty Ltd (In Liquidation) v Edgar* (1993) (Vic).

Consequences of an illegal contract

If a contract is found to be illegal at common law or by statute, then it is unenforceable. Strictly, this means that the contract is not enforceable by either party, including an innocent party. It may be possible, however, for the innocent party to seek relief by an independent cause of action.

Bowmakers principle

In *Bowmakers Ltd v Barnet Instruments Ltd* (1945) (CA), the plaintiff (Barnet) sued the defendant (Bowmakers) in tort seeking damages for conversion. The goods in question were the subject of hire purchase

contracts which were illegal because they contravened the (UK) Defence of the Realm Regulations. In breach of the hire purchase contracts, the defendant sold the goods. The court held that, because the plaintiff was able to assert its ownership to the goods, and because it sought relief independent of the illegal contract, it was able to succeed in tort. This decision has been criticised in subsequent cases because it was not entirely clear how the plaintiff was able to assert its ownership of the goods without relying on the illegal contracts, apart from the defendant conceding the point. By contrast, in *Thomas Brown and Sons Ltd v Fazel Deen and Another* (1962) (HC), the plaintiff (Fazel Deen) deposited gold, jewellery and a safe with the defendant (Thomas Brown) in 1943. In 1959, the plaintiff requested the return of his property, but it could not be located. The plaintiff subsequently instituted tort proceedings. It transpired that the bailment contract, in relation to the gold, was illegal under the (Cth) National Security Regulations, and the trial judge found that the goods had disappeared not later than April 1953. Given that the bailment contract itself was illegal and unenforceable, and also given that an action in conversion would have been statute-barred, the plaintiff's action was based on detinue. The plaintiff succeeded in relation to the jewellery and the safe, but not in relation to the gold, because he had to rely on an illegal bailment contract to support his claim. In the course of their judgment, the court distinguished the *Bowmakers* case.

Collateral contract

This exception involves a situation where one party has guaranteed that a contract will be performed legally, and the other party entered into the contract in consideration of that guarantee. If the guarantee is not honoured, then the innocent party can enforce it as a collateral contract. In *Strongman (1945) Ltd v Sincock* (1955) (CA), the defendant (Sincock), an architect, entered into a contract with the plaintiff (Strongman), a builder, and undertook to obtain the appropriate licences to enable the building project to be completed. The plaintiff subsequently did work which exceeded the terms of the licences granted and which was therefore illegal under an existing statute. In subsequent litigation, the defendant raised the illegality by way of defence. In reply, the plaintiff argued that the defendant had agreed to obtain the appropriate supplementary licence to cover the excess work, and that this promise was collateral to the main (illegal) contract. The court agreed and held that the collateral contract was unaffected by the illegality.

Statutory cause of action

A statute itself may provide a party to an illegal contract with an independent cause of action. In *Ison v Australian Wheat Board* (1967) (NSW), the plaintiff (Ison) purchased wheat from third parties in contravention of a statute. The defendant (Wheat Board) took possession of the wheat and the plaintiff was prosecuted. The plaintiff subsequently argued that he was entitled under the statute to receive a payment for the wheat seized. The relevant section stated that compensation was 'payable to the person who would have been entitled to receive the price of the wheat, if the wheat had been lawfully sold'. The court ordered the payment because it was satisfied that the plaintiff might have been in a position to lawfully sell the wheat to potential buyers, notwithstanding that the plaintiff's contract to purchase the wheat was illegal.

A claim in restitution

A claim in restitution to recover moneys paid under an illegal contract is not an enforcement proceeding, but rather an independent cause of action.

A claim based in *quantum meruit*

As with restitution, a claim in *quantum meruit* ('as much as he has earned') is an action to recover reasonable compensation for services rendered, and is not based on a contract, illegal or otherwise.

Contracts void by statute

A statute may declare a contract void, rather than illegal and unenforceable. In other words, Parliament may, for whatever reason, decide to deprive particular contracts of their legal efficacy rather than to simply outlaw them. As the contract is void, rather than unenforceable, any money or property transferred under it is generally recoverable. For example, all Australian States and Territories have legislation that renders 'null and void' any gaming or wagering contracts that are made with unlicensed bookmakers or other gaming operators. In *Delfina v Kenny* (1946) (HC), the plaintiff (Kenny), a licensed bookmaker, took a wager from the defendant (Delfina). As the wager had not been documented in the manner required by statute, the defendant argued that the betting contract was null and void. The court agreed and also noted that any winnings would not be recoverable.

Contracts rendered partially void by statute

While some statutes may render a contract void for all purposes, other statutes are more limited in their application. For example, a statute may stipulate that the contract is only void against certain persons. Some examples follow.

(Cth) Income Tax Assessment Act 1936

Section 260 provides that any contract that is specified in the provision is 'absolutely void as against the Commissioner [of Taxation]'. In other words, the Commissioner can ignore the contract for taxation purposes, because it never existed. Similar anti-avoidance provisions apply under the State and Territory stamp duties legislation.

(Cth) Bankruptcy Act 1966

Section 122(1) provides that any contract that is specified in the provision is 'void as against the trustee in bankruptcy'. Section 122(2) provides, however, that the rights of third parties who entered into contracts with the bankrupt party 'in good faith and for valuable consideration' are unaffected. It is worth noting that there are other sections within this statute, and indeed within the national Corporations Law, that achieve a similar result.

Terms rendered void by statute

A statute might direct the invalidity to a term of the contract rather than the contract as a whole. An example we have already discussed is the (Cth) Trade Practices Act 1974; in particular, s 68 (see Chapter 6, p 60).

Consequences of a void contract

A void contract is one that the law treats as never having existed. Any money or property transferred under a void contract is recoverable unless prohibited by statute. In addition, any collateral contract is affected by the void main contract.

Doctrine of severance

Where a contract contains a term that is void for illegality, the court may allow the offending term to be severed, leaving the remainder of the contract enforceable.

Tests for severance

There are two broad tests that need to be satisfied before a term can be severed:

- (a) the illegality must be of a relatively minor degree and not taint the contract as a whole;
- (b) the term must be severable in the technical sense – if the severance of the term would destroy the sense of the contract or leave it meaningless, the court will not redraft the contract.

In *Price v Green* (1847) (Ex), a restraint of trade clause in a sale of business contract stipulated that the seller would not compete ‘within the cities of London or Westminster, or within the distance of 600 miles from the same respectively’. The court held that the ‘600 miles’ provision was unreasonable, but that the remainder of the restraint (that is, ‘within the cities of London or Westminster’) was reasonable and divisible. By contrast, in *Baker v Hedgecock* (1888) (Ch), the court refused to minimally redraft a restraint of trade clause to make the length and distance reasonable. Chitty J noted that if a court were to create a new covenant, it would be creating something that the parties had not agreed to. He also noted that in *Price v Green* there were in fact two covenants, or one covenant capable of division. Lastly, in *Thomas Brown and Sons Ltd v Fazal Deen* (1962) (discussed previously, p 133) the court was able to sever the illegal aspects of the gold bailment so that the contract relating to jewellery and safe bailment could be enforced.

(NSW) Restraints of Trade Act 1976

The (NSW) Restraints of Trade Act 1976 provides that a ‘restraint of trade is valid to the extent to which it is not against public policy, whether it is in severable terms or not: see s 4(1). The party subject to a restraint of trade may apply to the court ‘to make the restraint a reasonable restraint’: see s 4(3).

12 Discharge

You should be familiar with the following areas:

- discharge by performance
- discharge by agreement
- discharge by breach
- discharge by operation of law
- discharge by frustration

Introduction

Discharge relates to the process of bringing a valid and enforceable contract to an end. A contract may be discharged (or terminated) by:

- (a) performance of the contract;
- (b) agreement between the parties;
- (c) a breach of the contract (actual or anticipated);
- (d) operation of the law;
- (e) a frustrating event.

Effect of discharge

Once a contract has been discharged, each party is released from any further obligations under it. Terminating a contract must be distinguished from rescission of a contract. The voiding of a contract by rescission has the effect of sterilising it retrospectively as to formation (that is, the law treats the contract as never having existed). The contract is terminated retrospectively, and not just prospectively. With discharge, the contract is only terminated prospectively (that is, the contract existed up until the time of termination, but not afterwards). This effect has certain legal consequences. In particular, all rights and liabilities that accrued up until the time of termination

remain enforceable. In addition, certain clauses in the contract may continue in existence (or at least that they continue to be of legal effect). Examples include exclusion, restraint of trade and arbitration clauses.

Discharge by performance

Entire contract principle

The general rule is that a party will only be discharged from the obligations under a contract if complete performance has taken place (that is, performance must be exactly in accordance with the terms of the contract). Partial performance is insufficient and may result in a party being treated as having done nothing at all. In *Cutter v Powell* (1795) (KB), the plaintiff's husband (Cutter) signed on as second mate on the defendant's (Powell's) ship on a voyage from the West Indies to England. The service contract provided that the plaintiff's husband would be paid 30 guineas 'provided he proceeds, continues and does his duty as second mate ... to the port of Liverpool'. The plaintiff's husband died seven weeks (about 75%) into the voyage. When the defendant refused to pay the plaintiff any of her late husband's wages, she sued for recovery of a proportionate amount. The court held that as the contract was 'entire', the plaintiff could not succeed. Her husband had failed to perform his promise and there was no entitlement to pay part of the salary. Not surprisingly, there are at least six exceptions to this principle:

- (a) the *de minimis* rule;
- (b) divisible contracts;
- (c) substantial performance;
- (d) acceptance of partial performance;
- (e) obstruction of performance;
- (f) statute – State and Territory Sale of Goods legislation.

***De minimis* rule**

The law does not concern itself with trivialities (*de minimis non curat lex*). In other words, the law is unlikely to punish a party who fails by an insignificant margin to complete the performance of a contract

exactly. In *Shipton Anderson and Co v Weil Brothers and Co* (1912) (KB), the court held that a purchaser could not reject a consignment of wheat which was 55 pounds (about 25 kilograms) over the required weight of 4,950 tons. Even more curious was the fact that the purchasers were not even charged for the extra 55 pounds!

Divisible contracts

A contract may stipulate that performance is to be completed in stages or segments. If so, performance of less than the entire contract whole may be sufficient to confer partial rights on the performing party. In *Government of Newfoundland v Newfoundland Railway Co* (1887) (PC), the defendant (Government) agreed to grant 25,000 acres (about 10,000 hectares) of land to the plaintiff (Railway) for each five mile (eight kilometre) section of railway constructed. The plaintiff only completed 25% of the required sections. The court held that the defendant was bound to grant the plaintiff 25,000 acres of land for each of the five mile sections completed notwithstanding that the whole contract was not performed. In other words, each five mile section was divisible or severable from the entire contract.

Substantial performance

The doctrine of substantial performance has been developed to assist a party overcome the entire contract principle. In *Hoenig v Isaacs* (1952) (CA), the plaintiff (Hoenig) agreed to redecorate the defendant's (Isaacs') flat for £750. He was to be paid 'as the work proceeds, and balance on completion'. The defendant made progress payments totalling £450, but refused to pay the balance, alleging poor workmanship requiring rectification. The plaintiff sued for the outstanding amount and, by way of defence, the defendant argued the entire contract principle. The court held that although the work was partially defective, the defects were easily fixed and, in any event, the plaintiff had substantially performed his obligations. This meant that the plaintiff was entitled to the agreed price less the cost of the necessary remedial work. The issue of whether the performance is substantial will, of course, depend on the facts of each individual case.

Acceptance of partial performance

If a party chooses to accept part performance by the other party to a contract, then this acceptance may constitute a discharge except where the accepting party had no option but to accept the partial performance. In *Sumpter v Hedges* (1898) (CA), the plaintiff (Sumpter)

agreed to build two houses for the defendant (Hedges). The plaintiff only completed half of the required work before abandoning the jobs because he did not have any finance to complete them. The defendant arranged for third parties to complete the work. The plaintiff sued on a *quantum meruit* basis for an amount representing the work done. The court held that the entire contract principle applied. There was no evidence to support any argument that the defendant had accepted partial performance or had acted in a way that caused the plaintiff to abandon the jobs.

Obstruction of performance

If one of the contracting parties is prevented or obstructed by the other party from performing the contract, then the court may order the contract discharged. In *Sumpter v Hedges*, the court noted that there was no evidence to support any argument that the defendant had acted in a way that caused the plaintiff to abandon the jobs. In *Startup v Macdonald* (1843) (CCP), the plaintiff (Startup) agreed to sell 10 tons of oil to the defendant (Macdonald) that was to be delivered 'within the last 14 days of March'. The plaintiff attempted to deliver the oil at 8:30pm on Saturday 31 March but the defendant refused to accept the goods or pay for them. The court held that the tender of performance was sufficient as it was within the term specified in the contract. The plaintiff was entitled to be paid for the goods (contrast with the State and Territory Sale of Goods legislation below).

State and Territory Sale of Goods legislation

The State and Territory Sale of Goods legislation provides as follows:

- there are now rules for delivery of goods (for example, goods must be delivered to the buyer at a reasonable hour): NSW, s 32; Vic, s 36; Qld/NT, s 31; SA/WA, s 29; Tas, s 34; ACT, s 33;
- if a specified quantity of goods is ordered, but less than agreed quantity is delivered, a buyer may either reject all the goods delivered or accept the goods and pay for them at the rate specified in the contract: NSW, s 33; Vic, s 37; Qld/NT, s 32; SA/WA, s 30; Tas, s 35; ACT, s 34;
- unless agreed, a buyer is not bound to accept delivery of goods by instalments: NSW, s 34; Vic, s 38; Qld/NT, s 33; SA/WA, s 31; Tas, s 36; ACT, s 35.

Discharge by agreement

The parties may vary or discharge an existing contract 'by agreement', either by a term within the original contract, or by a subsequent contract, or by giving reasonable notice of termination.

Discharge by prior agreement

A contract may provide for its own commencement or termination upon the occurrence or failure of some named event. A condition precedent is a term in a contract that provides that until a specified event occurs, either no agreement actually exists, or if a contract exists, no performance is required. By contrast, a condition subsequent is a term that specifies that the contract will end, or be varied, upon the happening of a specified event. In *Head v Tattersall* (1871) (Ex), the plaintiff (Head) agreed to buy a horse from the defendant (Tattersall) and the contract included a term that the horse could be returned if it proved that it did not have the hunting experience specified. In subsequent litigation, the court held that this term was a condition subsequent that if the warranty as to hunting experience proved untrue, the horse could be returned and the price refunded.

Discharge by subsequent agreement

The contractual parties may enter into a further contract to vary or discharge the original contract. The subsequent contract must, of course, validly comply with all the formation requirements. The original contract may be amended or discharged in the following ways.

Mutual or bilateral discharge

This occurs where the contracting parties agree to discharge one another from the promises made in the original contract despite the fact that either or both of the parties have failed to perform as promised, or that only partial performance has taken place.

Release or unilateral discharge

This occurs where one contracting party, who has completed his or her performance of the contract, agrees to release the other party from

further performance. To be enforceable, the release must be made by deed or supported by consideration.

Accord and satisfaction

This occurs where one contracting party is in breach of the contract, and the other party agrees to release that party from the breach by performance of another promise. The original contract is discharged by 'accord and satisfaction'. The new contract is the accord and the new promise or its performance is the satisfaction.

Novation

Novation involves the substitution of a new contract in place of the original contract, either between the same parties or third parties. Novation circumvents the problems associated with the privity of contract rule (see Chapter 7).

Waiver

Waiver arises where one of the contracting parties leads the other party, who is in breach of the contract, to reasonably believe that exact performance is not required. This is sometimes called promissory estoppel (see Chapter 4). The term 'waiver' can also be used to describe a situation where one party grants the other party an extension in time for performance, or where a party, who has the option of terminating a contract, affirms it, thus waiving the right to rescind the contract.

Reasonable notice

A contract that does not stipulate a date for completion (that is, a continuing or 'open ended' contract) can usually be discharged by the giving of reasonable notice of termination by one party to the other. In *State Bank of New South Wales v Commonwealth Savings Bank Ltd* (1985) (Fed), Lockhart J noted that each contract had to be construed according to its own special facts, and that in long standing contracts, short term notice would not be acceptable.

Discharge by breach

A breach occurs when one of the contracting parties fails to perform some or all of the obligations stipulated by the contract. There are two forms of breach of contract:

- (a) actual breach – actual failure to perform the contract;
- (b) anticipatory breach – a renunciation or repudiation of the contract by one of the contracting parties demonstrating an intention, express or implied, that the contract will not be performed.

Actual breach

The right of a contracting party to terminate a contract for actual breach must be assessed objectively. In *Maple Flock Co Ltd v Universal Furniture Products (Wembley) Ltd* (1934) (CA), the plaintiff (Maple) entered into a contract to sell certain goods to the defendant (Universal). One term of the contract provided that the goods were to conform to prescribed government standards as to chemical composition. Another term provided for deliveries to take place three times per week. Subsequently, one of the delivered loads contravened the prescribed chemical standard. The defendant argued that, given this breach, it was entitled to terminate the contract. The court disagreed. In reaching its decision, the court looked at two factors:

- (a) the seriousness of the breach in relation to contemplated performance;
- (b) the degree of probability that the breach will be repeated.

The court found that, as there was no reasonable probability of any repetition of the breach, the defendant was not entitled to repudiate the contract or refuse further deliveries.

Anticipatory breach

The significance of the anticipatory breach is that a contracting party can act as though the breach anticipated by the conduct of the other party has actually taken place. In other words, a party need not wait until the other party actually breaches the contract before seeking termination or another remedy.

Express repudiation

Express repudiation involves a refusal by one of the contracting parties to perform the contract as agreed. In *Foran v Wight* (1989) (HC), the plaintiff (Foran) entered into a contract to sell land to the defendant (Wight) on 24 December 1982. The contract included a term that required the plaintiff arrange for a 'right of way' to be registered, and a further term that completion (or 'settlement') take place on or before 22 June 1983. On 20 June 1983, the plaintiff informed the defendant that completion could not take place on the essential day because the required 'right of way' had not been registered. As it transpired, the defendant had difficulties in obtaining finance and would not have been in a position to complete on the essential day either. Subsequently, the defendant purported to terminate the contract. The court held that, even though the defendant would not have been able to complete the contract on the essential day, the plaintiff's anticipatory breach was converted by repudiation into an actual breach allowing the defendant the right to terminate.

Implied repudiation

Implied repudiation involves an inability by one of the contracting parties to perform to contract. This inability is implied from the conduct of that contracting party. In other words, it may be objectively apparent that the relevant party is incapable of performing a contract even if that party expresses an intention to actually perform it. In *Universal Cargo Carriers Corp v Citati* (1957) (QB), the plaintiff (Citati) agreed to charter a ship from the defendant (Universal) from Basrah to Buenos Aires. The ship arrived in Basrah on 12 July 1951, but the plaintiff had no cargo to load. Under the contract, the plaintiff had until 21 July to load the cargo. As the defendant believed that the plaintiff would not be in a position to load any cargo by the due date, it chartered the ship to a third party on 18 July. In the ensuing litigation, the court held that the contract had been discharged because the plaintiff's conduct had demonstrated an intention not to perform. The court stated that the cause of the plaintiff's inability to get the cargo to the ship in time for loading was immaterial.

Effect of a breach of contract

The effect of a breach of a contract, whether actual or anticipated, depends upon whether the term breached is a condition, warranty or

intermediate term. When the breach involves an essential term or condition, the innocent party is faced with an election between:

- (a) affirmation of the contract – conduct indicating an intention to treat the contract as continuing;
- (b) termination of the contract – conduct indicating an intention to treat the contract as being at an end.

A breach of a warranty does not entitle the innocent party to terminate the contract. The remedy lies only in damages or specific performance. A breach of an intermediate term may or may not give the innocent party the right to terminate. This depends on the seriousness of the breach (see Chapter 6). In *Luna Park (NSW) Ltd v Tramways Advertising Pty Ltd* (1938) (HC), the plaintiff (Tramways) entered into an advertising contract with the defendant (Luna). The contract was to place advertising on Sydney trams for a minimum period of 52 weeks. It was a term of the contract that the plaintiff ‘guarantee’ that these advertisements ‘will be on the tracks at least eight hours per day throughout your [that is, Luna Park’s] season’. In subsequent litigation, the defendant argued that the plaintiff had breached the ‘guarantee’ term by not displaying each advertisement for eight hours per day. The court held that the defendant was entitled to terminate the contract. The term was an essential feature of the contract. Latham CJ stated that ‘the words ‘we guarantee’ are particularly suited, in a contract drawn by laymen, to emphasise the importance of the clause which they introduce’.

Discharge by operation of law

A contract may be discharged by the operation of law. This may include:

- (a) the doctrine of ‘merger’;
- (b) alteration or cancellation of a written document;
- (c) bankruptcy or company liquidation.

Merger

It is possible for the so called ‘inferior’ rights that exist in one contract to be absorbed or merged into a subsequent ‘superior’ contract between the parties. If the contracting parties enter into a deed in substantially similar terms as their simple contract, the rights and obligations of both parties will be determined solely by reference to the deed. Common examples follow.

Contractual debts

If a creditor obtains a court judgment, then the right to enforce the contractual debt merges into the judgment.

Land transactions

The sale of land usually involves two stages. First, the parties exchange binding contracts. Secondly, at some future time, the parties complete or settle the contract by handing over the title deed and a registrable conveyance or transfer. The effect of this is to merge the contract into the conveyance (that is, the superior document).

Alteration or cancellation of a written document

Where a written contract is deliberately altered by one of the contracting parties, without the consent of the other party, that act will discharge the contract to the extent that the guilty party will be unable to rely upon or enforce the contract. In *Croockewit v Fletcher* (1857) (Ex) the defendant (Fletcher) entered into agreement to allow the plaintiff (Croockewit) to ship certain cargo on '15 March next'. Subsequently, the plaintiff arranged, unbeknown to the defendant, for the words 'wind and weather permitting' to be added after the contractual date. When the truth surfaced, the court refused to allow the plaintiff to assert any rights under the contract.

Bankruptcy or company liquidation

Under the (Cth) Bankruptcy Act 1966, a bankrupt may be provided with a statutory discharge from contracts entered into with creditors. Similarly, under the national Corporations Law, a corporate entity may be provided with a similar statutory discharge.

Frustration**Absolute performance**

The 'entire contract' principle requires absolute performance. A contracting party is bound to perform the contract even though subsequent external circumstances or events may render performance impossible. In *Paradine v Jane* (1647) (KB), the plaintiff (Paradine) leased property to the defendant (Jane) and subsequently sued for arrears. The defendant argued that he had been expelled from the property by 'a certain German prince, by the name of Prince Rupert, an alien born,

enemy to the King' who had invaded England. The court held that this fact was not a defence and did not excuse the defendant from performance under the lease. The court stated that, 'when [a] party by his own conduct creates a duty or charge upon himself, he is bound to make it good ... notwithstanding any accident'. The rule is justified on the basis that it is possible for the contracting parties to provide for external or other contingencies within the contract itself. Nevertheless, given that the rule often produced harsh results, judicial modification or exceptions were inevitable.

Doctrine of frustration

In *Taylor v Caldwell* (1863) (QB), the plaintiff (Taylor) entered into a contract to hire the defendant's (Caldwell's) music hall for a series of concerts. Six days before the first concert, an accidental fire destroyed the premises. As the hire contract made no provision for such a contingency, the plaintiff sued for the rent due. The court held that the destruction of the actual subject matter of the contract excused both parties from any obligation to perform the contract. The court noted that neither party was responsible for starting the fire. In other words, the contract contained an implied term that both parties would be discharged from their contractual obligations if performance under the terms of the contract became impossible because of some subsequent event, without either party being at fault. Similarly, in *Krell v Henry* (1903) (CA), the defendant (Henry) hired a room from the plaintiff (Krell) for the period 26–27 June 1902. The purpose of the hire was to view the forthcoming coronation procession of Edward VII; however, due to the King's illness, the procession was subsequently cancelled and the parties ended up in dispute over the contract. The court was satisfied that both parties were aware of the real object or foundation of the contract (that is, to view the procession). The court held that the cancellation of the procession had the effect of discharging the parties from their obligations under the contract.

The doctrine of frustration is based on the view that a frustrating event changes the nature of performance to such an extent that there is no longer any real contract between the parties (*non haec in foedera veni* – 'it was not this that I promised to do'). In *Davis Contractors Ltd v Fareham UDC* (1956) (HL), the plaintiff (Davis) entered into a contract with the defendant (Fareham) to build 78 houses during an eight month period. For various reasons, the project took 22 months to complete and ran nearly 20% over budget. It appears that the plaintiff entered into the contract believing that there was sufficient skilled

labour in the area. The plaintiff subsequently sued for the extra cost under a *quantum meruit*, claiming that the contract had been frustrated by the labour shortage. The court disagreed and held that the contract was not frustrated. In the words of Lord Radcliffe:

... frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract.

Elements constituting frustration

For the doctrine of frustration to apply, three essential elements are satisfied. The subsequent frustrating event must:

- (a) not have been contemplated by the parties at the time of the contract;
- (b) not be caused by either party;
- (c) cause a fundamental or radical change to the rights and obligations under the contract.

First element: no foreseeability

In *Davis Contractors Ltd v Fareham UDC* (1956) (HL) (see above), Lord Radcliffe stated that one reason why the plaintiff's argument in frustration failed was the fact that the possibility of a skilled labour shortage 'was before [the parties] eyes and could have been the subject of special contractual stipulation'. Obviously, frustration will not succeed where a contract actually makes special provision for a subsequent event. In *Claude Neon Ltd v Hardie* (1970) (Qld), the plaintiff (Neon) entered into a five year contract to hire to the defendant (Hardie) a neon advertising sign to be installed at the defendant's rented premises. The contract contained a term that in the event that the defendant's leasehold interest in the subject premises was 'extinguished or transferred', then the rent due for the remaining period of the contract would become due and payable. Two years later, the subject premises were resumed and demolished and the plaintiff sought payment of the balance due. The defendant refused, arguing that the contract had been frustrated by the resumption of the property. The court disagreed and held that the alleged frustrating event had been specifically contemplated, and dealt with, by the contract itself.

The standard of foreseeability is strict, and the fact that a frustrating event was reasonably foreseeable is not generally sufficient. In *Simmons Ltd v Hay* (1964) (NSW), the plaintiff (Hay) was employed as a printer's engineer by the defendant (Simmons) for a fixed period. Subsequently, the plaintiff became permanently incapacitated by illness and was unable to discharge his duties under the employment contract. The plaintiff later commenced an action for wrongful dismissal. The court held that the employment contract was discharged by frustration notwithstanding the fact that when the plaintiff was employed, the defendant knew that he was unwell. The court was satisfied that the parties could not reasonably have contemplated that the plaintiff would suffer a permanent disability. This decision should be contrasted with *Krell v Henry* (1903) (CA) (see above, p 147).

Second element: not self-induced

A party cannot rely upon self-induced frustration to discharge a contract. In *Maritime National Fish Ltd v Ocean Trawlers Ltd* (1935) (PC), the defendant (Maritime) chartered a boat from the plaintiff (Trawlers). At the time the contract was entered into, both parties knew that a particular licence was required by the defendant in order to use the ship as required. Subsequently, some licences were issued to the defendant. The defendant, who had the right to nominate which of its chartered boats were covered by the licences, chose not to nominate the one subject to the charter contract with the plaintiff. When the plaintiff sought payment under the charter contract, the defendant refused arguing frustration. The court held the doctrine did not apply because the frustrating event was a deliberate action on the part of the defendant.

The onus of proof rests upon the party alleging the self-induced frustration. In *Joseph Constantine Steamship Line Ltd v Imperial Smelting Corporation Ltd* (1942) (HL), the defendant (Constantine) chartered a ship to the plaintiff (Imperial) to carry cargo from Australia. Just prior to the proposed loading of the cargo, there was an engine room explosion that extensively damaged the ship. In subsequent litigation, the defendants argued that the charter contract was frustrated. The court agreed and stated that the party alleging self-induced frustration (that is, in this instance, negligence) bears the burden of proof. On the evidence, the plaintiff had not established that the defendant had been, through any negligence or fault, responsible for the explosion.

Third element: fundamental change to performance

The supervening event must cause a radical or fundamental change in the nature of the contracting rights and obligations. In *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) (HC) (also discussed in Chapter 6), the plaintiff (Codelfa) entered into a contract with the defendant (SRA) that related to the construction of Sydney's eastern suburbs underground railway. The contract contained a term as to the length of time for construction, and more particular, there was a clear understanding between the parties that the work was to be carried out by three continuous work shifts, six days per week, and that the plaintiff would not be restrained from doing so. Subsequently, an injunction was granted in favour of a third party that significantly restricted the construction hours and increased the associated costs. The plaintiff argued that performance of the contract was frustrated by this fundamental change in circumstances. The court held (by a 4:1 majority, Mason, Stephen, Aicken, Wilson JJ; Brennan J dissenting) that the contract was frustrated because, after the injunction was granted, the contractual obligations were fundamentally different from that contemplated by the contract. In other words, there had been a radical change in the nature of the plaintiff's performance as required by the contract.

Generally, frustration will not arise where the changed circumstances cause mere inconvenience to a party or make performance more serious or expensive. In *Tsakiroglou and Co Ltd v Noble Thorl GmbH* (1962) (HL), the defendant (Tsakiroglou) entered into a contract with the plaintiff (Noble) to sell certain goods. A term of the contract provided that the defendant was responsible for the shipping costs. Due to the closure of the Suez Canal, the cargo ship was forced to detour via the Cape of Good Hope. This change doubled the travelling time and greatly increased the shipping costs. The contract did not stipulate either a particular time for the delivery or any particular route to be taken by the shipper. In the ensuing litigation, the court held that since no specified route had been agreed to, the shipper should use the one most readily available under the circumstances. While the court conceded that the detour would increase transportation costs, it held that this did not provide sufficient grounds to justify an application of the doctrine of frustration.

Arguments raising frustration

There are various categories of case that follow where the doctrine of frustration has been successfully argued.

Destruction of the subject matter of the contract

The timing of the destruction or alteration is crucial. In *Taylor v Caldwell* (1863) (QB) (see above, p 147), the destruction of the music hall took place after the contract was entered into. If the fire had occurred before the contract was entered into, it would involve a situation of common mistake rendering the contract void *ab initio*.

Failure of a condition or event

The doctrine may arise where the basis of the contract is dependent on the continued or future existence of a particular set of circumstances that subsequently cease to exist or fail to eventuate. In *Krell v Henry* (1903) (CA) (see above, p 147), the cancellation of the coronation procession discharged the parties as it was no longer possible to achieve the substantial purpose or object of the contract. However, in *Herne Bay Steamboat Co v Hutton* (1903) (CA), the defendant (Hutton) hired a boat from the defendant (Herne) 'for the purpose of viewing the naval review and for a day's cruise around the fleet'. The naval review was part of the later-cancelled coronation celebrations for Edward VII. When the defendant refused to pay for the hire, the plaintiff sued. The court held that the cancellation of the naval review did not frustrate the contract. While the parties knew that the boat was to be used to observe the promised naval review, that was not the sole basis or object of the contract. It would have still been possible for the defendant to have 'a day's cruising around the fleet'.

Personal service

The doctrine may apply in a situation where a party to a contract for personal services subsequently dies, falls ill, or is physically prevented from performing under the contract. In *Horlock v Beal* (1916) (HL), the plaintiff's husband (Beal), shortly before the outbreak of the First World War, entered into a two year contract to serve as a crew member on the defendant's (Horlock's) ship. The plaintiff's husband subsequently agreed to assign half his wages to the plaintiff. Later that year, the plaintiff's husband was captured and imprisoned by the Germans. The plaintiff later sued the defendant for her share of her husband's wages. The court held that, as the service contract had been frustrated by the incarceration, both contracting parties were discharged from further performance.

Change in the law or government interference

The doctrine may apply in a situation where a change of law makes performance either illegal or impossible. In *Denny Mott and Dickson Ltd v James B Fraser and Co Ltd* (1944) (HL), the plaintiff (Denny) entered into a contract with the defendant (Fraser) to purchase timber. The contract included a term that gave the plaintiff the option of purchasing the defendant's timber yard should either party terminate the contract. When war was declared in late 1939, the government subsequently declared timber sales illegal. Some time later, the plaintiff gave notice of termination and sought to exercise the option. In subsequent litigation, the court held that the contract was frustrated by a change in the law.

Frustration may also occur when government intervention or interference prevents proper performance of a contract. The interference must be substantial and have the effect of radically altering performance: see *Metropolitan Water Board v Dick Kerr and Co* (1918) (HL). The overall result can often be unfair, particularly if one of the contracting parties remains liable for payment for a benefit that cannot be enforced. In *Re Continental C and G Rubber Co Pty Ltd* (1919) (HC), a contract was entered into between Continental and another party (Anderson) to carry out certain work on Continental's property during 1914. Following the declaration of war, Continental was placed under the control of a statutory officer as enemy agents held a controlling interest. Consequently, Anderson was prevented from completing the contract. When Anderson subsequently sought compensation for breach, the statutory officer sought a court direction as to Continental's contractual liability. The court held that, as the contract was frustrated, Anderson was not entitled to any compensation for Continental's failure to perform. However, the court also held that Continental was not entitled to be refunded for any moneys paid in advance to Anderson. In contrast, the House of Lords took a different approach in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* (1943) (HL). In this case, the plaintiff (Fibrosa) entered into a contract with the defendant (Fairbairn) to supply machinery for delivery in Poland. When war broke out, the law was changed to make it illegal for a British company to supply goods to a country occupied by an enemy, such as Poland. The court held that this frustrated the contract. However, the court also held that where there had been a total failure of consideration, any advance payments are recoverable in quasi-contract. In some Australian States, this problem has been partially solved by statute (see below, p 153).

Frustrated contracts legislation

Three States have now enacted legislation that modifies the common law doctrine of frustration.

(Vic) Frustrated Contracts Act 1959

Under s 3(2), all moneys paid under a contract prior to the frustrating event are recoverable. Under s 3(3)–3(5), the court has the power to make an adjustment between the parties to produce a ‘just’ result. The court may have regard to all the relevant circumstances including any expenses incurred by the payee party.

(NSW) Frustrated Contracts Act 1978

Under s 7, an unperformed promise, due to be performed before the frustrating event, is discharged, except to the extent necessary to support an action for damages for breach of the promise. As with the Victorian statute, s 12 provides that all moneys paid under a contract prior to the frustrating event are recoverable, but a much more elaborate code for adjustment exists. Where a party has provided full performance, s 10 allows that party to recover a sum ‘equal to the value of the agreed return for the performance’ (that is, as contemplated by the contract). Where only partial performance has taken place, s 11 sets out an adjustment procedure. The basic idea is that the nominated consideration should be apportioned in an equitable manner. If the parties are unable to make the adjustments set out in ss 10–13, then s 15 allows a court to make an appropriate adjustment.

(SA) Frustrated Contracts Act 1988

Under s 6(1), frustration discharges the parties from all the remaining obligations under the contract. This provision does not effect any obligations that the parties agreed would survive frustration, or prevent a party seeking damages for a pre-frustration breach. As with the statutes in Victoria and NSW, s 7 provides for an adjustment ‘between the parties so that no party is unfairly advantaged or disadvantaged in consequence of the frustration’. The adjustment procedure is set out in s 7(2).

13 Remedies

You should be familiar with the following areas:

- causation of damage
- remoteness of damage
- measure of damages
- mitigation
- equitable remedies
- statutory remedies and statute of limitations

Damages

Damages are the traditional remedy for an innocent party who is the victim of a breach of contract by the other party. The purpose of awarding damages is to compensate the innocent party for the loss sustained because of the breach, and not to punish the other party. Before a court can measure the level of damages to be awarded, it must consider and answer two questions:

- (a) was there is a causal connection between the innocent party's loss or damage and the other party's breach?
- (b) was the loss or damage too remote (that is, reasonable foreseeability)?

Causation

Causation is a question of fact, not law. In *March v E and MH Stamare Pty Ltd* (1991) (HC), the court stated that, 'as a matter of ordinary common sense', the other party's breach must be regarded as a cause of the innocent party's loss. If there are concurrent causes for the loss or damage, it is sufficient if the other party's breach is a cause. However, if the loss or damage is caused by factors for which the other

party is not responsible, the causation connection will not be established. In *Alexander v Cambridge Credit Corporation* (1987) (NSW), the defendants (Alexander and others), who were the plaintiff's (Cambridge's) auditors, allegedly breached their service contract by performing their services negligently. Despite their alleged breach, the defendants were held not responsible for the subsequent financial losses suffered by the plaintiff. The court was satisfied that the losses were caused by a substantial downturn in the property market, and the decision of the plaintiff to expand its operations during unfavourable economic conditions. In his judgment, McHugh JA stated that the causation issue is determined by reference to the 'but for' test. In other words, would the plaintiff's loss have occurred but for the defendant's breach of the contract?

Remoteness

The innocent party's loss or damage must not be too remote. In *Hadley v Baxendale* (1854) (Ex), the defendant (Baxendale) agreed to transport the plaintiff's (Hadley's) broken crankshaft from the plaintiff's mill in Gloucester to the manufacturer in Greenwich. It was a term of the contract that the crankshaft would be delivered by the following day. In breach, the defendant caused a delay in the delivery of the broken crankshaft. As a result, the plaintiff's mill was idle for an extended period of time. In subsequent litigation, the plaintiff claimed damages for loss of profits for the period the mill was idle. The court held that the defendant was not liable for the loss of profits caused by the delay, as the damage did not directly flow from the breach of the contract. In the course of the judgment, the court stated that there are two types of loss for which a party in breach may be liable:

- (a) loss occurring in the 'usual course of things from such a breach';
- (b) loss occurring as a result of special or exceptional circumstances where such were made known to the party in breach at the time of the contract.

In *Victoria Laundry (Windsor) Ltd v Newman Industries Limited* (1949) (CA), the defendant (Newman) agreed to sell the plaintiff (Victoria) a boiler for use in its laundry business. It was a term of the contract that the boiler be promptly delivered, as it was intended to 'put it into use in the shortest possible space of time'. The boiler was damaged during dismantling, resulting in delivery being delayed for nearly six months. The court held that the plaintiff was entitled to recover the profits that

it could have expected from increased capacity, had the boiler been operable. These damages were recoverable because the defendant knew that the plaintiff wanted the boiler for immediate use. The plaintiff was unsuccessful, however, in claiming damages for the loss of the highly lucrative dyeing contracts. These damages were not reasonably foreseeable and were, therefore, too remote. In order to claim these additional damages, the plaintiff would have had to bring the possibility of profits from these dyeing contracts to the attention of the defendant. Asquith LJ stated that reasonable foreseeability depends 'on the knowledge then possessed by the parties or by the party who later commits the breach'. Knowledge may be actual or constructive. Actual knowledge means that the party actually knew what the situation was. Constructive knowledge means that a reasonable person would have recognised what the situation was.

Measure of damages

Damages are generally measured in terms of lost expectation. In a contractual situation, the expectation would normally be based upon lost earnings, in addition to costs suffered as a result of a breach. In *Marks v GIO Australia Holdings Limited* (1998) (HC), Gaudron J stated that:

... damages are payable for the loss involved in non-performance of the contract. Even if a contract is not susceptible of specific performance, the other party is legally entitled to expect its performance. Hence the expression 'expectation loss'!

There are other bases that exist for the measure of damages.

Reliance damages

Where an innocent party incurs expenses in the performance of a contract and thereafter discovers that the other party is in breach, damages may be measured in terms of the innocent party's reliance on the contract. In *McRae v Commonwealth Disposals Commission* (1951) (HC) (see Chapter 8), the court awarded as damages the costs incurred by the plaintiff (McRae) in sending out a fruitless salvage expedition. However, the expenses incurred before the contract comes into existence are not generally recoverable. Nevertheless, damages may be available for any expenditure that has occurred after the contract was made, but before any performance commences (that is, pre-operational

expenditure). In *Commonwealth of Australia v Amman Aviation Pty Ltd* (1990) (HC), the plaintiff (Amman) entered into a contract with the defendant (Commonwealth) to conduct an aerial coast watch service for northern Australia. The contract was to commence on 12 September 1987, and this gave the plaintiff six months in which to purchase and equip itself to carry out the service. The completion date was not stipulated to be 'of the essence'. During this period, the plaintiff expended a considerable sum of money in acquiring equipment and employing staff. By notice on 12 September 1987, the defendant purported to terminate the contract. The basis of the termination was that the plaintiff had breached the contract by not operating all the scheduled flights on the commencement date. In the subsequent litigation, the court held that the defendant had wrongly repudiated the contract. Consequently, the plaintiff was entitled to compensation for the expenses it had incurred in reliance on the contract, the cost in equipping itself for the performance of the contract, and the cost of the termination payments to its employees.

Non-economic damages

Generally, damages are not awarded to compensate for non-economic matters, such as embarrassment or distress. In *Addis v Gramophone Co Ltd* (1909) (HL), the defendant (Gramophone) wrongfully dismissed the plaintiff (Addis) from his employment. The plaintiff subsequently sued for damages for wrongful dismissal. At first instance, the plaintiff received damages that included an amount for the embarrassment, humiliation and general distress suffered by the plaintiff and caused by the way in which he was dismissed. On appeal, the House of Lords set this award aside as not being the proper subject for damages. By contrast, in *Jarvis v Swan Tours* (1973) (CA), the plaintiff (Jarvis) purchased a package holiday to Switzerland on the strength of statements that appeared in a travel brochure. The holiday subsequently failed to live up to most of the statements made in the brochure. The court awarded the plaintiff damages that included an amount for the disappointment suffered by him as a result of the ruined holiday. Similarly, in *Baltic Shipping Co Pty Ltd v Dillon* (1993) (HC), the plaintiff (Dillon) was awarded damages that included the disappointment she suffered following the sinking of the cruise liner, the *Mikhail Lermontov*, off New Zealand.

Pre-agreement as to damages

The law will accept a contractual provision for liquidated or agreed damages if it represents a reasonable and genuine pre-estimate of the expected loss. However, the law will not enforce an agreed damages clause if it is in the nature of a penalty. A penalty is a liquidated amount that bears little relationship to the anticipated loss. The relevant time for determining whether a clause is a penalty clause is at the time of the contract. The onus of proof rests on the party alleging that it is a penalty clause. In *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* (1915) (HL), a contractual term provided that damages of £5 per tyre was payable by the defendant (New Garage) for breach. The defendant subsequently argued that the term was a penalty clause and therefore was not enforceable. The court held that the plaintiff (Dunlop) was entitled to the amount claimed because the clause was not a penalty but a *bona fide* attempt to estimate likely loss flowing from the breach.

Mitigation

The innocent party who suffers from a breach of contract must take reasonable steps to mitigate (that is, to lessen) the loss suffered. The underlying principle is that the law will not allow recovery of losses that the innocent party could have avoided by prompt and reasonable action. However, any moneys spent in mitigating or attempting to mitigate losses are recoverable as damages.

Equitable remedies

Equitable remedies include:

- (a) rectification;
- (b) specific performance;
- (c) injunction.

Rectification

A party to a contract may apply to the court to have the contract rectified if there is a discrepancy in the written document (for further discussion, see Chapter 8).

Specific performance

A party to a contract may apply to a court for an order that the other party in breach specifically perform the contract (that is, carry out the promises made). Being a discretionary remedy, the court will not grant specific performance where:

- (a) there will be injustice or hardship to the party in breach;
- (b) damages are an adequate remedy;
- (c) the remedy is not available to both parties;
- (d) the contract is otherwise defective (for example, for illegality or unconscionability);
- (e) the contract is for personal service – in *Lumley v Wagner* (1852) (Ch), the defendant (Wagner) agreed to sing exclusively at the plaintiff's (Lumley's) theatre for a three month period. When the defendant subsequently purported to sing for a third party, the plaintiff sought an order for specific performance. The court held that the order was not available to compel her to sing as she had promised;
- (f) constant supervision will be required – in *JC Williamson Ltd v Lukey* (1931) (HC), the defendant (Williamson), a lessee of a theatre, entered into a contract allowing the plaintiff (Lukey) an exclusive right to sell confectionery at the theatre. When the defendant purported to grant a similar contract to a third party, the plaintiff sought specific performance. The court refused to grant specific performance because it will not make an order that requires it to exercise continuing supervision.

Injunction

An injunction is an order of a court directing a party not to do something or to stop doing something: see *Cardile v LED Builders Pty Ltd* (1999) (HC). As with specific performance, an injunction is a discretionary remedy and will not be granted where:

- (a) there will be injustice or hardship to the party in breach;
- (b) damages are an adequate remedy;
- (c) the effectiveness of the remedy is suspect;
- (d) the party seeking the injunction is in breach or is not ready, willing and able to perform the contract;
- (e) there is no danger that the breach complained of will continue;

- (f) the effect of the injunction would be to compel the defendant to do something that could not be ordered by specific performance.

Loss of equitable remedies for breach

An equitable remedy may be lost by application of the doctrine of laches. This applies to situations where an innocent party has acquiesced in the other party's breach and has not taken action against the defaulting party within a reasonable time. In such circumstances, the court may, in its discretion, refuse to grant relief because this could prejudice the other party.

Statutory remedies

Relevant statutory remedies have been referred to throughout this text. For example, remedies are available under the (Cth) Trade Practices Act 1974 (in particular, ss 80, 82 and 87) or equivalent State and Territory Fair Trading legislation for misleading, deceptive or unconscionable conduct arising in a contractual setting.

The State and Territory Sale of Goods legislation also provides remedies for breach of contract. For example, a seller may take action to recover the price of goods where ownership has passed and the buyer has refused to pay in accordance with the terms of the contract: NSW/Qld/NT, s 51(1); Vic, s 55(1); SA/WA, s 48(1); Tas, s 53(1); ACT, s 52(1). In addition, where a buyer wrongfully neglects or refuses to accept and pay for goods, the seller may maintain an action for non-acceptance and the measure of damages is the estimated loss directly resulting from the buyer's breach of contract: NSW/NT, s 52; Vic, s 56; Qld, s 51; SA/WA, s 49; Tas, s 54; ACT, s 53.

Lastly, in NSW, the court is empowered to rewrite 'unjust' contracts: see (NSW) Contracts Review Act 1980.

A final note – statute of limitations

Each State and Territory has legislation that prevents legal action, contractual or otherwise, being taken after a specific period of time. The aim of the legislation is to protect a potential defendant from having to defend an action in circumstances where it would be

difficult to do so, such as where vital evidence no longer exists or where witnesses are no longer living. The relevant statutes are:

- (a) (NSW) Limitation Act 1969;
- (b) (Vic) Limitation of Actions Act 1958;
- (c) (Qld) Limitation of Actions Act 1974;
- (d) (SA) Limitation of Actions Act 1936;
- (e) (WA) Limitation Act 1935;
- (f) (Tas) Limitation Act 1974;
- (g) (NT) Limitation Act 1981;
- (h) (ACT) Limitation Act 1985.

Simple contracts

In all States and Territories (except NT), an action in respect of a simple contract must be commenced within six years from the date the cause of action (for example, breach of contract) arose. In the Northern Territory, the statutory period is three years.

Formal contracts

An action in respect of a deed must be commenced within 12 years (in NSW, Queensland, Tasmania, ACT and NT); 15 years (Victoria and South Australia); and 20 years in Western Australia.

Statutory actions

An action claiming misleading, deceptive or unconscionable conduct under the (Cth) Trade Practices Act 1974 or equivalent State and Territory Fair Trading legislation should be commenced within three years from the date of the alleged breach of the statute. Other relevant legislation referred to in this text have specific limitation periods.

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