

Understanding the Contractual Relationship

Workshop C
Financial Management Series
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Overview

- I. Contract formation
 - Key Elements
- II. Types of Contracts
- III. Contract Termination

PART I - Contract Formation

- Contract
 - An agreement –
 - Between two or more persons
 - Enforceable at law
 - Parties to contract:
 - Freedom of contract
 - Create specific rights and duties
 - Key Elements = valid contract

Elements of a Valid Contract

1. Intention - to create a legal relationship
 2. Offer
 3. Acceptance
 4. Consideration
 5. Capacity to contract
 6. Legality
- Requirements must be met for a contract to be enforceable

Elements of a Valid Contract

Part II

7. Requirement of writing

- For certain contracts

Part III

8. Free of vitiating elements

- Mistake
- Misrepresentation
- Undue influence
- Duress

1. INTENTION

- **Meeting of the minds**
 - Consensual agreement of the parties
 - To subject and object of the contract
- **Promise**
 - Party intended to be bound by promise made
- **Intention is a presumption at law**

Presumptions

- Presumptions in contract law
 - Strangers intend to be bound by promises
 - Not family members and close friends
 - Both presumptions can be rebutted
- Invitation to do Business
 - Advertisements are not offers
 - Invite offers that seller may accept or reject

2. OFFER

- Tentative promise subject to a condition
- Must be communicated to the other party to be accepted
 - Cannot accept an offer you do not know of
 - Crossed offers – in the mail do not constitute a contract
 - Only person to whom offer is made may accept it

3. ACCEPTANCE

- A statement or act given in response to and in accordance with an offer
- Must be communicated in the manner requested or implied by the offeror in the offer
 - By words or conduct

Acceptance Rules

Offeror is master of their offer - dictate form

- Verbal acceptance - either phone or direct speaking
- Postal Rule - when letter is placed in the postbox
- Other modes - not complete until offeror made aware of acceptance
 - Reaches offeror
 - Acceptance complete when and where received

Acceptance Rules

- **Must be clear and unconditional**
 - Conditional: => Counteroffer is a rejection of an offer and is a new offer
 - Silence is not acceptance unless pre-existing agreement to this effect exists
 - Exception: party assented
 - Consumer protection reinforces common law rule of silence is not acceptance

Acceptance Rules

- If a method of acceptance is stated then offeree must comply with requirements
 - If only preference for a particular method of acceptance is stated then:
 - And other mode given, acceptance would only be effective when it was received by the offeror
- Unilateral Offers
 - An offer made to the world at large
 - The performance of the act is acceptance
 - Offeror cannot revoke offer when offeree is in the course of performing their part

Lapse of an Offer

- Lapse
 - Unaccepted offer can be terminated:
 - Passage of time – stated or reasonable time, subject matter and circumstances
 - Counteroffer
 - Death of a party
- Rejection - offer cannot be accepted later unless the original offer is revived

Revocation of an Offer

- Termination of an offer:
 - By notice communicated to the offeree before acceptance
 - Unless there is an option
 - Separate promise to keep an offer open for a period of time, requires consideration or signed under seal
 - Must be communicated to the offeree
 - In any form
 - Can be communicated through someone else (indirect)
 - Must prove offeree had notice indirectly from a reliable source

4. CONSIDERATION

- **Something:**
 - Has value in the eyes of the law
 - What a party gets in return for their promise
 - A benefit or a detriment
 - Money
 - Services
 - Promise not to do something
 - Relinquishment of a right
 - Delivery of property
 - Promise for a promise
- No consideration = no contract

Gratuitous Promise

- A promise without consideration
 - Not enforceable under law
- Exceptions:
 - Gratuitous services
 - Must be performed with care and skill
 - Negligence still applies – sue in tort not contract
 - Negotiable Instruments
 - Still liable on a cheque or note and to subsequent endorsers even though no consideration exists

Exceptions

- Charitable Donations
 - Most are gratuitous promises
 - May be enforceable promise if charity can show a specific project undertaken on strength of a donor's pledge
 - Needs to be a substantial portion
 - Not enforceable if not significant donation

Seal as Consideration

- Seal
 - A formal mode of expressing the intention to be bound by a written promise or agreement
 - A major exception to the rule of consideration
 - The deliberate act of placing a seal on a document is intention to be bound
 - Contract under seal requires no consideration

Adequacy of Consideration

- General Rule
 - Courts not concerned about the adequacy of consideration
 - Exception: if the promise was made under unusual circumstances
 - One cannot snap up an offer
 - Inadvertent typos (rule of rectification)
 - Consideration must be legal
 - Cannot be illegal or a violation of public policy or Statutes

Past Consideration

- Past consideration is no consideration
 - Must be given before contract entered into, not after
 - Cannot be something the person received before promise is made
 - Cannot be something a person is already entitled to receive at law or under a present contract
- New contract requires new consideration

Consideration Remedies

- Quantum Meruit
 - Definition - “as much as he has earned”
 - Quasi-contractual remedy that permits a person to recover a reasonable price for services and/or materials where no price established when the request made
 - Court decides on price based on price of similar goods or services in the area

Consideration

Debtor-Creditor Relationship

- Gratuitous promise - reduction of a debt
 - Creditors agree to accept less than what is owed
 - New promise requires new consideration
 - Exceptions to this rule exists for business efficiency
 - Sign under seal
 - Acceptance of something other than money
 - Pay before the due date
 - Third party makes the payment

Consideration

Equitable/Promissory Estoppel

- A person may not deny the truth of a statement of fact made by him or her when another person has relied and acted upon it
 - Promise enforceable without consideration
 - Only used as a defense, not an action
 - Prevents retraction of promise if:
 1. Promise relates to an existing legal relationship
 2. Expression of a fact as being true
 3. Reliance on statement by other party
 4. Reliance is a detriment to the other party

5. CAPACITY

Capacity - the ability to enter into a contract

- Not all persons can enter into contracts
- Law protects those who may lack the ability to appreciate the nature of their acts
 - Minors
 - Drunken and Insane Persons
 - Corporations
 - Labour unions
 - Bankrupt persons
 - Illegal Agreements
 - Legality at Common Law

Minor/Infant

- Not reached the age of majority
- Public policy - minors should not be bound by their promises
- Contract is enforceable by the minor but not against the minor
 - Voidable at the option of the minor

Exceptions: Minors Liable for:

1. Contracts for Necessaries
2. Beneficial Contracts

Minor's Right of Repudiation

- Test: Is the contract an:
 - Executed Contract – may be enforceable
 - Executory – may not be enforceable
- Fraudulent Misrepresentation as to Age
 - If misrepresented then may be able to repudiate
- Statutory Protection - generally
 - Ratification must be in writing
 - Non-necessaries/debt contracts - “absolutely void”
- Minors Engaged in Business
 - At Age of majority - repudiate or implied ratification
 - Partnership - not liable for debts of partnership incurred as a minor

Drunken and Insane Persons

- Mentally Disabled
 - If committed – cannot incur any liability (contract is void)
- Temporary Mental Impairment
 - Physical or mental damage
 - Result of drugs or alcohol

Mental Impairment

- Bound in contracts for necessaries
- Not bound for non-necessaries
 - Voidable at impaired persons option if:
 - Can establish was in such a condition when the contract was entered into
 - The other party was aware of the condition when the contract was entered into
 - Contract must be repudiated immediately after reaching capacity or will be implied ratification

Corporations

- Regular Corporations
 - Same powers as a natural person
 - Limitations internal bylaws (articles of incorporation) not public knowledge
- Special Act Corporations
 - Powers controlled by special act
 - Limitations public knowledge because in a statute
- Ultra Vires - act that is beyond the legal authority
 - Regular Corporations
 - Bound by contracts that are ultra vires
 - Special Act Corporations
 - Not bound by contracts that are ultra vires

Other Entities

- Labour Unions
 - Under labour legislation can enter into collective agreements which normally would be unenforceable
- Bankrupt Persons
 - Limited capacity to contract
 - Only for necessaries until discharged

6. Legality

- Legality Requirement:
 - Contracts unenforceable if
 - Offend public good
 - Purpose is illegal
 - Some contracts rendered voidable if the parties did not comply with statute or public policy
 - Illegal contracts
 - Agreement to commit a crime (rob, assault, abduct, murder, steal goods, or prohibited by the Criminal Code)
 - Embezzlement – when crime discovered, a contract by employee of restitution in return for not reporting is against public policy

Legality - Statute Law

- Competition Act
 - Restraint of Competition - unenforceable
 - Act covers a number of business practices contrary to public policy
- Administrative Acts
 - Workers Compensation, land use planning, wagering laws - violation void and unenforceable
- Insurance Policies
 - Wagers (bets) are unenforceable, general rule
 - Exception - insurance contracts (life)
 - Requirement: an insurable interest

Legality - Statute Law

- Unlicensed Persons
 - Purpose is protection of the public
 - Contracts with unlicensed trades or professions is illegal
 - Must still pay for goods supplied but not for services rendered
 - Only voidable at option of party who is not the tradesperson or professional

Legality at Common Law

- Public Policy

- Courts unwillingness to enforce rights that are contrary to the general interests of the public

- Examples

- Obstruct justice, injure public service, injure the state, stifle prosecution
 - Contracts for the commission of a tort, immoral acts
 - Exorbitant interests rates
 - Some are merely unenforceable whereas others are unenforceable and illegal

Contracts in Restraint of Trade

Three Categories:

1. Agreements contrary to the Competition Act
 2. Non competition agreements with the purchase and sale of a business
 3. Non competition agreements in employment contracts
- Last 2 dealt with under public policy

Sale of a Business

Restrictive Covenant:

- A contractual clause limiting future behavior
- Prima facie void as a restraint of trade
- Allowed if the restriction is reasonable as to:
 1. Time
 2. Business restricted
 3. Geographical area

Employment Agreements

- Non Competition Clauses:
 - Not enforceable unless serious injury to an employer can be clearly demonstrated
- Confidentiality
 - Enforceable more often than non-competition clauses
 - Based on duties of employee in the employment relationship not upon a restraint in trade
- Public Interests
 - Restrictive covenant against employees who provide an essential service may not be enforceable if would result in injury to the public

PART II. TYPES OF CONTRACTS

7. Requirement of Writing

- Formal and Simple Contracts
- The Statute of Frauds
 - Executors and Administrators
 - Guarantees
 - Contracts concerning an interest in land
- Requirements for the Written Memo
 - Parol evidence
 - Condition precedent
 - Implied terms
 - Collateral agreements
 - Subsequent agreements
- Reduction to Writing - MOU
- Sale of Goods Act

Formal and Simple Contracts

Two General Classes of Contracts

1. Formal (derives its validity from its form)
 - Not common
2. Informal (simple) (most common)
 - Implied
 - Oral
 - Written

Example of a formal contract - Power of Attorney

A legal document usually signed under seal in which a person appoints another to act as his or her attorney to carry out the contractual or legal acts specified in the document

Statute of Frauds

Contracts covered by the Statute of Frauds

- Certain contracts have to be in writing to be enforceable
 - Still valid and existing contracts for other purposes (not void or prohibited)
- 1. Contracts by Executors and Administrators
- 2. Guarantees
- 3. Assumed liability for a tort
- 4. Contracts concerning an interest in land

Land Contracts

Doctrine Part Performance

- Permits the courts to enforce an unwritten land contract:
 1. Acts performed relate to land in question
 2. Lack of a written memo would perpetuate a fraud and a hardship on the person
 3. Agreement must relate to an interest in land
 4. Agreement must be valid and enforceable apart from the requirement of writing and verbal evidence must be available to establish the existence of the agreement

Written Memorandum

Requirements:

- Need not be in a formal document
- Need all terms of contract
 - 3 P's: parties, property, price
- Can be an exchange of letters
 - 2 letters together can constitute an agreement in writing
- Must be signed by the party against whom it is being enforced

Parol Evidence Rule

Rule

- Evidence cannot add to or contradict contract terms
- Only evidence to prove terms of a contract

Exceptions:

- Condition Precedent
- Doctrine of Implied Term
- Collateral Agreement
- Common Factor
- Subsequent Agreement

MOU - Reduction to Writing

- Negotiations
 - Issue of when a contract agreed to orally becomes enforceable if it is never reduced to writing
 - Issue of interim enforceability between time of oral agreement and being put into writing

Sale of Goods Act

- Writing Requirement
 - Certain transactions over a certain value if not in writing are unenforceable
 - Methods of enforcement (without written requirement)
 - Payment of a deposit
 - Acceptance of delivery of part of the goods
 - Giving of something “in earnest” (like a trade-in)

PART III- TERMINATION:

8. Free of Vitiating Elements

Failure to Create Valid Contract

- **Mistake:**
 - Law, Fact, Non est factum, Unilateral and Mutual mistake
- **Misrepresentation**
 - Innocent, Fraudulent, Negligent
- **Undue Influence**
- **Duress**

Mistake

- One or both parties formed erroneous opinion as to identity of subject matter or important term
 - Does not express their true intentions
- Types of Mistake
 - Mistake of law – no relief
 - Mistake of fact - may get relief
 - Non est factum – not of my doing
 - Unilateral and Mutual mistake

Mistake of Fact

- Court may provide relief
 - Mistake as to subject matter of contract
 - General rule - contract is void
 - Mistake as to identity of the Party
 - Depends if the identity of the person is an essential element of the agreement
 - If essential may not be enforceable
 - If not essential – it will be enforceable

Mistake of Fact

- Non Est Factum
 - Defense that may allow illiterate/infirm persons to avoid liability on a written agreement if:
 - Establish that they were not aware of the true nature of the document; and
 - Were not careless in execution
 - Applies only to type of agreement being signed not to the terms of the agreement

Unilateral and Mutual Mistake

- Unilateral Mistake
 - A mistake by one party to the agreement
- Mutual Mistake
 - Both parties have made mistaken assumptions as to the subject matter
 - Can be same mistake or different mistakes
 - Courts will not enforce agreements when the other party is aware of the mistake being made

Mutual Mistake

- Rules
 - If both parties make the same mistake:
 - as to subject matter then the contract is unenforceable
 - As to identity of the parties
 - Deal with on a case by case basis
 - Rectification
 - Correction of a mistake that would have rendered the agreement impossible to perform

Misrepresentation

- Characteristics
 - A statement or conduct
 - Induces the other party to enter into the contract
 - Must be a material matter
 - Must be a statement of fact and not opinion
 - Exception: expert opinion
 - Statement made before contract entered into

Misrepresentation

- Result of misrepresentation
 - Voidable at the option of the injured party
 - Must rescind or lose the right if accept benefits under the contract
- Rescission
 - The revocation of a contract or agreement

Misrepresentation

- 3 Types

- Type

- Remedy

- Innocent

- rescission only

- Fraudulent

- rescission and damages

- Negligent

- rescission and damages

Remedy depends on type of misrepresentation

Fraudulent Misrepresentation

- Fraudulent Misrepresentation
 - False statement of fact made by a person who knows or should know that it is false and made with the intention of deceiving another
- Tort - Deceit
 - Arises when a party suffers damage by acting upon a false representation made by a party with the intention of deceiving the other

Misrepresentation by Non-Disclosure

- General rule
 - No obligation to disclose
 - Exception:
 - Certain types of relationships or contracts
 - Contracts of utmost good faith
 - Insurance, Partnership (fiduciary obligation), special trust or confidence between the parties
 - Partial disclosure of facts has effect of rendering the part disclosed as false

Negligent Misrepresentation

- Negligence
 - Newer form of misrepresentation
 - Statements that are sufficiently reckless but not quite fraudulent

Undue Influence

- Undue Influence
 - A state of affairs whereby a person is so influenced by another that the person's judgment is not his or her own
 - Not in a fair bargaining position
- 2 Scenarios
 - Special Relationship exists (trustee/beneficiary)
 - Special Relationship does not exist
- Onus on dominant party to prove otherwise

Undue Influence

- No undue influence if
 - Agreement was fair and reasonable in the circumstances
 - Full disclosure is made prior to the formation of contract
 - Weaker party free to seek independent legal advice
- Contract is voidable at option of weaker party

Duress

- Threat of injuring or imprisonment for the purpose of requiring another to enter into a contract or carry out some act
 - Threat can be to person directly or to person's family (or a close relative)
 - Contract is voidable at option of person once they come out from under duress
 - Threat to person and not person's goods

Discharge

- Performance
 - Tender of payment
 - Tender of performance
- Discharge
 - Termination
 - External events
 - Express terms
 - Implied terms

Performance

- Done according to terms of contract
 - Must be exact and precise for discharge
 - Anything less is a breach
- Act of performing a contract or the offer of payment of money due under a contract
 - Tender of Payment - when money paid at time and place required
 - Legal tender
 - Cannot be refused if tendered by buyer
 - Seller can refuse credit card, check, bill of exchange

Tender

- Debt
 - If proper tender of payment is made and refused by creditor, interest stops running
 - Debtor need not attempt to pay again
- Tender of Performance of an Act
 - Must deliver goods to proper place at proper time
 - If refusal by buyer seller need not tender again

Discharge by Other Means

- Termination as a Right
 - Option to terminate by one party giving notice to the other
 - Contract provides for a termination right
 - If done improperly may be liable for damages for improper termination

Discharge - External Events

- Express Terms
 - Occurrence of an event specified in contract
 - Condition Subsequent
 - Alters the rights or duties of the parties to a contract, or that may have the effect of terminating the contract if condition should occur
 - Force Majeure
 - Occurrence of major unforeseen event that prevents the performance of a contract or causes damage to property

Discharge - External Events

- Implied Terms
 - Occurrence of an event that by custom of the trade would normally result in exemption from liability
 - Condition subsequent are implied by the courts
 - Example: common carriers

Discharge - External Events

- Frustration
 - Performance by a party is rendered impossible due to an unforeseen or unexpected change in circumstances
 - Results in the contract being discharged
 - Should be inserted into the agreement
- Self-Induced Frustration
 - Doing something to avoid a contract
- Loss lies with the parties

Frustrated Contracts Act

- Allows:
 - Court to apportion loss equitably between the parties
 - Recovery of deposits and/or advances
 - Retention of funds to cover expenses when only part performance has occurred
- Some provinces have Frustrated Contracts Act, others are subject to the Common law

Discharge - Condition Precedent

- A condition that must be satisfied before a contract may come into effect
 - Contract prepared and signed, only performance is postponed
 - Discharged if condition not met
 - Inserted for the benefit of the one party, not both

Discharge - Operation of Law

- Discharged by operation
 - Enemy states
 - Specific legislation
 - Bankruptcy
 - Bills of Exchange Act
 - Doctrine of Laches
 - Statutory Limitations
 - Mergers

Discharge by Agreement

- Waiver
 - Express or implied renunciation of a right or claim
 - Consideration if neither party has fully performed
 - If one party fully performed but the other has not, performed party may waive rights to performance
- Novation
 - Mutual agreement to amend the terms or parties to an existing agreement

Discharge by Agreement

- Material Alteration
 - Major alteration of an agreement that has the effect of discharging the contract and replacing it with another
- Substitute Agreement
 - Substitution may effect the discharge

Discharge by Agreement

- Breach of Contract
 - Failure of a party to perform a contract according to its terms
 - One party may have right to discharge agreement
 - Express repudiation
 - Implied repudiation
 - Fundamental Breach
 - Warranty
 - Condition

Breach of Contract

- Breach:
 - Party has right to Damages, Rescission or Both
- Repudiation:
 - A refusal to perform a contract
 - Can be express or implied
- Condition
 - An essential term of a contract
 - Breach allows the other party to end the contract

Breach of Contract

- Anticipatory Breach
 - Advance determination that a party will not perform at the time for performance
 - May end the contract or continue with the contract
 - If continue one takes the chance the contract may be discharged in another way in the interim

Breach of Contract

- Repudiation
 - If partial performance can only rescind if repudiation goes to root of contract
- Doctrine of Substantial Performance
 - Cannot rescind a contract if it has been substantially performed
- Subsidiary Promise
 - Warranties where a sale of goods is concerned
 - Allow for damages but not rescission

Breach of Contract

- Implied Repudiation- inferring can be risky
 - Not expressly repudiated but through statements or conduct
 - Inadequate performance over a period of time may be implied repudiation
- Fundamental Breach
 - Breach that goes to the root of the contract
 - Allows injured party to rescind contract and sue for damages

Exemption Clauses

- Construed strictly against the party who inserted them (especially in standard form marketplace contracts)
- Allows parties to avoid exemption clauses
- Depends on the construction/ wording of the contract

Breach of Warranty

- Warranty
 - In a sale of goods, a minor term in a contract, the breach of which allows one to sue for damages but not rescission
 - Conditions may become warranties

Remedies - Compensation

- Right of injured party to sue for compensation for the loss suffered
 - Loss or injury must be proven
 - Courts attempt to place party into position would have been had the contract been performed i.e. original position
 - Can take the form of monetary damages, specific performance, or quantum meruit

Remedies - Damages

- General Damages
 - Restitution for losses naturally expected from a breach of contract
 - Put party into position they would have been had the contract been performed
 - Represents compensation for losses
 - Losses must flow naturally from the breach can not be too remote

Remedies - Damages

- Special Damages
 - Specific damages that would flow from a breach of contract
 - Do not arise naturally or generally from the normal course of events following such a breach
- Punitive Damages
 - Not compensation but punishment when actions were deceitful, malicious or offensive

Extent of Loss

- Contemplation Test
 - Reasonable foreseeability
 - Recoverable Damages that the parties may reasonably contemplate as flowing from breach
- Special Circumstances
 - Any loss that might occur from special circumstances relating to the contract that parties might reasonably be expected to contemplate at the time the contract is made

Remedies - Mitigation

- Obligation of an injured party to reduce the loss flowing from a breach of contract
- Must take steps to mitigate losses
- Find a new buyer or Find a new seller

Remedies - Liquidated Damages

- Bona fide estimate of the monetary damages that would flow from the breach
 - Attempt by the parties to estimate damages in the case of a breach e.g. deposits
- If unreasonable amount then penalty clause
 - Penalty clauses are unenforceable
 - Like punitive damages which are not allowed for ordinary breaches

Remedies – Specific Performance

- Equitable remedy
 - Granted when damages would be inadequate
 - Requires the defendant to carry out the agreement according to its terms
- Discretionary remedy
 - Force the party to do something they agreed to do
 - Must be a unique subject matter
 - Land, antiques, rare goods

Remedies - Injunction

- Equitable remedy
 - Orders the person(s) named therein to refrain from doing certain acts
 - Prevent party from doing something they agreed not to do
- Discretionary remedy

Remedies – Quantum Meruit

- Usually in situations of services or mixed goods/services
- Remedy not based on the contract but upon quasi-contract
- Available if contract has been partly performed
- Courts concerned with compensation for the work performed

Summary

- Contracts
 - Promises enforced by the courts
- Requirements
 - Intention, Offer, Acceptance, Consideration, Capacity, Legality, Requirement of Writing
- Free of vitiating elements
 - Mistake, Misrepresentation, Duress and Undue Influence

Summary

- Terminate/Discharge a Contract
 - Performance, Law, Frustration, Agreement, or Breach
- Remedies
 - Monetary damages - restore party to original position
 - Specific Performance - limited situations
 - Injunction - prevent someone from doing something
 - Quantum Meruit