chapter 9

Contract law 3

Learning objectives

At the end of this chapter you should be able to:

- identify the tests for determining whether a statement is a term of a contract
- distinguish between a condition and a warranty
- explain and provide examples of conditions precedent and conditions subsequent
- list the terms that may be implied in contracts by the courts, by statute and by custom or trade usage
- explain the meaning of an 'exemption clause' and the circumstances necessary before such a clause can be relied upon to escape liability
- explain the doctrine of privity of contract
- identify the circumstances that will discharge a contract
- explain the doctrine of frustration of contract and give examples of conduct that may frustrate a contract
- explain what is meant by a 'breach of contract' and the remedies available to the injured party
- give examples of speciality contracts
- define a 'franchise agreement' and explain the legal regulation covering such agreements.

Summary of contents

This chapter will cover:

- tests for determining the terms of a contract
- classification of express terms
- conditions precedent and conditions subsequent
- implied terms in contracts
- exemption and exclusionary terms
- doctrine of privity of contract
- discharge of a contract
- frustration of contract
- breach of contract
- remedies for breach of contract
- speciality contracts.

Introduction

In the last two chapters, we considered the elements required to form a contract. We will now examine some principles of contract law that are relevant once a contract has been made. Assuming the six essential elements are present, we will consider the terms of a contract, both express and implied. Only parties to a contract can enforce a contract. This is because of the doctrine of privity of contract. We will discuss this doctrine.

Once a contract exists, it must at some stage end or terminate. The term used by the law is 'discharge of contract'. The ways in which a contract can be discharged will be considered. It is not unusual for one or more of the parties to a contract to fail to meet their obligations. A breach of contract will occur in such a case. Breach of contract will be discussed, as will the remedies available to the injured party in such a case.

We will identify some speciality contracts such as leases, hire purchase agreements and franchise agreements, and discuss the legal rules applicable to such contracts.

Key terminology

The following terms will be used throughout this chapter:

accord and satisfaction	a method of discharging a contract by creating a new contract
breach	a failure to do what is promised; a failure to fulfil an obligation
condition	a fundamental term of a contract
condition precedent	a condition that must be satisfied before the contract can be enforced
condition subsequent	a term in a contract that provides that on the happening of a particular event the contract will terminate
damages	an amount of money payable to a person to compensate that person for a loss
discharge	to extinguish a legal obligation
doctrine of privity of contract	provides that only the parties to a contract can sue or be sued on a contract
exclusionary/exemption clause	a clause that seeks to exempt or exclude liability of one of the parties to a contract
franchise agreement	a contract where the franchisor agrees to allow the franchisee to sell and market a product or service, while retaining the rights to the product
frustration	impossibility of performing a contract that has the effect of discharging the contract
hire purchase agreement	an agreement in which a person hires goods from a retailer in exchange for regular payments, and can eventually become the owner of the goods
injunction	a court order that prevents a person from performing or continuing to perform a particular act
lease	a contract whereby one party grants exclusive possession of property to another party for a period of time
legal tender	the amount of money that a creditor is bound to accept in payment of a debt
merger	occurs where a right is extinguished because it coincides with or is incorporated into a greater right
novation of contract	a contract between two parties is rescinded in consideration of a new contract being entered into
remedies	legal means by which wrongs and losses are redressed
rescission	the right to set aside a contract
specific performance	an equitable remedy requiring a person to perform their obligations pursuant to a contract
tender	attempted performance
warranty	a term of a contract that is not of fundamental importance

TERMS OF A CONTRACT

The terms of a contract are its **contents**. The terms contain the obligations of each party. Sometimes it is necessary to determine whether a statement or representation is a term of a contract.

Tests for determining the terms of a contract

Often it is easy to identify the terms of a **contract**. They are written or verbal, and either express or implied. We will consider express and implied terms later.

Statements made during negotiations

How do you determine if a statement or promise made during negotiations is a term of a contract? When a contract is negotiated, there may be much discussion between the parties. Not all statements made by the parties at this stage become part of the contract (i.e. become terms of the contract). The law draws a distinction between statements that are '**mere representations**' and statements that are '**terms**' of a contract. An example of the latter includes a statement where a party promises or warrants that a statement is true. The distinction is important because of the remedies available if the statement is untrue. Damages can be awarded for statements that are terms of a contract, but cannot be awarded for a breach of a mere representation. The matters considered by the law to be relevant to whether a statement has become a term of a contract are set out in Table 9.1.

TABLE 9.1 Matters relevant to determining if a statement has become a term of a contract

Key question	Relevant considerations
When was the statement made?	■ Early stage of negotiations ■ Close to the time contract concluded
In what form was the statement made?	■ Written terms ■ Verbal terms ■ Was a verbal statement included in a written contract?
Was the statement made by a person with specific skills or expertise?	■ Reliance required ■ May be a term of contract
What was the intention of the parties?	■ Parties must intend the statement to be a term ■ Objective test used by courts

CASE EXAMPLE

Dick Bentley Productions Ltd v. Harold Smith (Motors) Ltd [1965] 2 All ER 65

Facts: During negotiations for the purchase of a Bentley motor vehicle, the defendant told Dick Bentley that the vehicle had a new engine and gearbox fitted. The defendant stated that the car had only been driven 20 000 miles (32 000 km). This statement was untrue but the defendant made it believing it to be true. When Bentley discovered that the car had travelled 100 000 miles (161 000 km) since the new engine was installed, he sued for breach of contract.

Decision: The court held that the statement about the distance travelled by the car had become a term of the contract. The person who made the statement, a Bentley dealer, had special knowledge and skill. The statement was made so that both parties should have realised that the buyer would rely upon it.

Intention of the parties

The intention of the parties is also relevant. If the parties intend a statement to be enforceable, it will be regarded as a **term**. An objective test is used by the courts: would a reasonable person say that the parties intended the statement to be enforceable and binding?

Collateral contracts

Establishing if a term is a condition

If a statement made prior to the contract being made is regarded as a 'mere representation' rather than a term of the contract, this will leave the representee with no remedy to sue for breach of contract. In order to overcome this disadvantage the courts have created the concept of a **collateral contract**. The court will hold that the statement that is made is a separate contract (a collateral contract). The representee is provided a remedy despite the fact that the representation is not a term of the contract. The consideration for the making of a collateral contract is the making of another contract.

The terms we have been discussing are called **express terms** of a contract. They are expressed either in writing or verbally or by a combination of both. There are also various ways of classifying these terms.

Classification of express terms

Express terms are classified by the law into two broad categories—a condition or a warranty—depending on their importance. Table 9.2 illustrates the significance and remedies attaching to conditions and warranties.

TABLE 9.2 Features of conditions and warranties

Term	Significance	Remedy if breached
Condition	Heart of contract Rescission of contract	Damages
Warranty	Of less importance	Damages only

Whether a term is a condition or a warranty must be determined by considering the facts of each case. If a party would not have entered a contract but for the existence of a particular term, this will indicate that the term is a condition.

Note that there are situations where a breach of condition can be treated as a breach of warranty.

CASE EXAMPLE

Luna Park (NSW) Ltd v. Tramways Advertising Pty Ltd (1938) 61 CLR 286

Facts: The plaintiff company held a licence from the Tramways Department in Sydney to display advertising on trams. The defendant company entered a contract with the plaintiff whereby its amusement park would be advertised on the tram's boards for at least eight hours a day over a specified period. The advertisement failed to meet this requirement. The issue was whether the term to advertise for at least eight hours a day was a condition or a warranty. The defendants argued it was a warranty, claiming that they only had to display the advertisement for an average of eight hours a day.

Decision: The High Court of Australia held that the term was a condition. The court said that the contract was worded so that the completeness of the display of the advertisement was an essential term of the contract. A breach of a condition entitled the defendants to damages and to rescind the contract.

CASE EXAMPLE

Bettini v. Gye (1876) 1 QBD 183

Facts: Gye made a contract with Bettini requiring Bettini to sing in operas and concerts for a three-month period. A term of the contract was that Bettini was required to be in London

for rehearsals at least six days before his first performance. He arrived only two days before. Gye attempted to rescind the contract on the basis that Bettini had breached a condition of the contract.

Decision: The court considered the length and nature of the performances to be given. The court held that the rehearsal clause was not vital to the agreement. The clause was regarded as a warranty, the breach of which entitled Gye to damages but not to rescind the contract.

In the case of *Hongkong Fir Shipping Co Ltd v. Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, the court stated that not all contractual undertakings would fall into the categories of either a 'condition' or a 'warranty'. The court said the more basic test was whether the breach had given rise to a situation where the party not in default had been deprived of substantially the whole benefit that they were entitled to expect from the contract.

Conditions precedent and conditions subsequent

Contract may be subject to a condition

The term 'condition' is used by the law in another context, other than to denote an essential term of a contract. A contract may be subject to a condition. Conditions, in this sense, fall into one of two categories: **conditions precedent** and **conditions subsequent**.

CONDITIONS PRECEDENT

A condition precedent is one that must be satisfied before the contract can be enforced. It must be satisfied before a contract can be said to exist.

EXAMPLE

A prospective purchaser signs a contract for the purchase of a house 'subject to finance' (i.e. subject to a financial institution approving a loan). Should the financial institution refuse, then the condition is not met, and no enforceable contract exists.

CONDITIONS SUBSEQUENT

Termination of contract

A condition subsequent is a term contained in a contract. It provides that on the happening of a particular event the contract will terminate. The event that fulfills the requirement of a condition subsequent may be either the happening of an event or the act of a party to the contract.

CASE EXAMPLE

Higgs v. Hodge Industrial Securities (1966) 111 SJ 14

Facts: A finance company and a car dealer entered an agreement under which a sum was to be paid in full satisfaction of an outstanding hire purchase liability. This agreement was made subject to the condition that new business would be introduced within seven days. The new business was not introduced within seven days due to a breach of the condition.

Decision: Failure to introduce the new business meant that the condition subsequent was not fulfilled and the contract was therefore at an end due to a breach of the condition.

Implied terms

Terms of a contract that are not express may be implied. Figure 9.1 illustrates the situations in which terms may be implied.

TERMS IMPLIED BY THE COURTS

Non-express terms

It is possible for a court to imply a term into a contract where clearly the parties intended it to be a term but for some reason it is not contained in the contract.

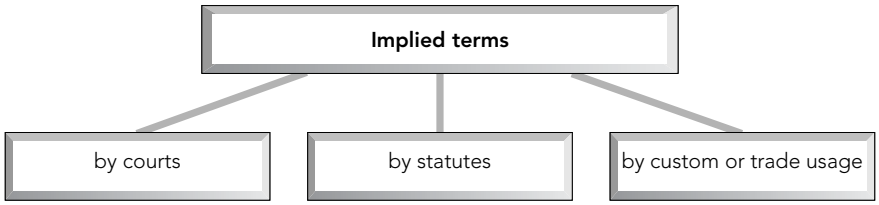

FIGURE 9.1 How terms may be implied

The courts have developed a test called the **officious bystander test**. In *Shirlaw v. Southern Foundries* (1926) Ltd [1939] 2 KB 206, Mackinnon LJ explained the test at 227 as follows:

> Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that … if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common 'oh, of course'.

Courts reluctant to imply terms

The courts are reluctant to imply terms into contracts. Five conditions must be satisfied before the courts will do so. These conditions are derived from a judgment of Lord Morris of the Privy Council in *BP Refinery (Westernport) Pty Ltd v. Shire of Hastings* (1977) 52 ALJR 20. In order to satisfy these five conditions, the term must:

1. be reasonable and equitable
2. be necessary to give business efficacy to the contract (i.e. the contract would be ineffective without it)
3. be so obvious that it goes without saying
4. be capable of being clearly expressed
5. not contradict any express term of the contract.

When will courts imply terms?

At common law, there are several types of contract in which the law will imply terms. For example, in contracts of employment, the courts will imply a term that the employer cannot require the employee to do anything unlawful. In contracts for the hire of goods, the courts will imply a condition that the goods will be reasonably fit for the purpose for which they have been hired.

CASE EXAMPLE

Breen v. Williams (1996) 138 ALR 259

Decision: The High Court of Australia found that the contract between a doctor and patient should not include an implied term granting the patient access to their records. Such a term was not necessary for the doctor to carry out the duty of care owed to the patient in the course of administering treatment. By implication, such a term was not necessary for the effective operation of the contract between the doctor and patient.

TERMS IMPLIED BY STATUTE

Merchantable quality

Some statutes imply specific terms into certain contracts. Examples are the sale of goods Acts and the *Trade Practices Act 1974* (Cwlth). These are discussed at some length in Chapters 12 and 13. They imply terms that goods will be of merchantable quality, correspond with their description and be fit for the purpose for which they have been purchased.

TERMS IMPLIED BY CUSTOM OR TRADE USAGE

Courts will imply terms into a contract where there is an established practice or custom in respect to certain agreements. Three conditions must be satisfied before a court will imply terms:

Conditions that must be met

1. The custom or usage is certain, reasonable and notorious. Griffith CJ explained this condition in *Young v. Tockassie* (1905) 2 CLR 470 at 478 as: ' … so well known that everyone making a contract in the terms used must be taken to have contracted with respect to that [custom]'.
2. The custom or usage will not be implied if it is inconsistent with any express term in the contract.
3. The custom or usage alleged must not offend any statutory principle.

CASE EXAMPLE

Con-Stan Industries of Australia Pty Ltd v. Norwich Winterthur Insurance (Australia) Ltd (1986) 160 CLR 226

Facts: It was argued by Norwich that where a broker had procured the signing of an insurance contract it was a custom in the insurance industry for the insurer to seek payment from the broker and not the insured party.

Decision: The argument failed. A number of insurance companies were found to seek payment directly from the insured party. There was insufficient evidence that the custom relied on was so well known and practised as to make it an implied term of the contract.

Exemption and exclusionary terms

Exemption clause must be a term of the contract

Often a party to a contract will seek to escape contractual liability by relying on a clause or term that exempts or excludes liability in certain instances. A party can rely on an exemption clause and avoid liability if it can show that the clause has become a term of the contract. The courts have devised several tests to ascertain whether a clause has become a term of a contract. Generally, exemption clauses can be divided into two groups: ticket cases and others.

TICKET CASES

'Reasonable person' test

Ticket cases are cases where the exemption clause relied on is contained on a ticket received by a party as a result of entering a contract (e.g. a ticket received when you park your car in a carpark or deposit your coat in a cloakroom). In such cases, the courts have applied a test to determine whether the exemption clause contained on the back of the ticket has become a term of the contract. The test is whether a reasonable person would regard the ticket as simply a receipt for payment or as a document containing contractual terms. If a reasonable person believes the latter, then the exemption clause has become a term and a party can rely on it to escape liability. If the ticket is simply regarded as a receipt, then the clause is not a term and liability cannot be avoided.

Notice of the clause

Ticket cases and other contracts containing exemption clauses require another element to be satisfied before the clause will be regarded as a term of a contract: **notice** of the clause must be given to the other party before or at the time the contract is made. Reasonable steps must be taken to notify persons of the exemption clause. Reasonable steps would be regarded as having been taken if the clause were brought to the attention of a reasonable person (i.e. a person not suffering any special disability, such as an illiterate person). An exemption clause will allow a party to escape from liability if it is brought to the attention of the other party. It is not necessary for the other party to have read the clause, provided this party has the clause in its possession or has notice of it and could have read it.

Generally an exemption clause will only absolve the party that is relying on it for liability in contract. It will not absolve a party from liability for negligent actions, unless specifically stated.

CASE EXAMPLE

Parker v. South Eastern Railway Co. (1877) 2 CPD 416

Facts: Parker deposited his bag at a railway station cloakroom. He was handed a ticket that had printed on its face 'See back'. On the back were several conditions. One condition was that the railway's liability for loss was limited to £10 per item. The bag was lost and the plaintiff claimed its full value of £24 10s.

Decision: The court held that Parker was bound by the exemption clause. Although Parker had not read it, the railway company gave him reasonable notice of the existence of the clause.

CASE EXAMPLE

Causer v. Browne [1957] VLR 1

Facts: The plaintiff's husband left one of the plaintiff's dresses with the defendant for dry cleaning. A week later, when the dress was collected, it was stained and some threads had been pulled out. The plaintiff sued and the defendant sought to rely on a clause printed on the docket that had been handed to the husband. The clause stated that the cleaners would not be liable for any loss of, or damage to, goods left for cleaning.

Decision: The court held that the cleaners could not rely on the exemption clause to escape liability. The document was not one that a reasonable person would assume to be contractual; it appeared only to be a receipt. A reasonable person receiving the docket would regard it as one that required presentation on collection of the items. The court held that no notice of the exemption clause had been given.

Notice of exemption clause must be given

CASE EXAMPLE

Oceanic Sun Line Special Shipping Co. Inc. v. Fay (1988) 62 ALJR 389

Facts: A document was provided to prospective Australian passengers in the absence of a cruise ticket being available. This document referred to conditions contained on the shipping contract and evidencing the terms of the contract. Prior to departing on the cruise in Greece, the passenger was given a ticket containing terms of which they had not been previously notified in Australia.

Decision: The High Court of Australia found that the terms contained on the ticket prior to embarkation in Greece were not terms of the contract. This was a consequence of the failure to give the passenger sufficient notice of the terms that had been added.

CASE EXAMPLE

Baltic Shipping Co. v. Dillon (The *Mikhail Lermontov*) (1993) 176 CLR 344

Facts: A prospective passenger on a cruise ship made a booking and paid the cost of the fare. The booking application made reference to the issue of the ticket being subject to certain conditions, which were printed on the ticket. The ticket was not provided to the passenger at the time the booking application was made. The conditions, which were printed on the ticket, could only be obtained by contacting the booking office of Baltic Shipping Co.

Decision: The New South Wales Court of Appeal found that Baltic Shipping could not rely on a significant exclusionary clause contained on the ticket relating to liability for passengers. The fact that the conditions of the contract were available at Baltic Shipping Co.'s office did not amount to sufficient notice of the exclusionary clause.

NON-TICKET CASES

If a party has signed a contract that contains an exemption clause, generally they will be bound by it. These cases do not involve a ticket being given to one person.

If contract signed, exemption clause will usually be binding

Table 9.3 illustrates the circumstances under which an exemption clause will be binding in ticket and non-ticket cases.

TABLE 9.3 When are exemption clauses binding?

Type of case	When binding?
Ticket cases	If a reasonable person believes that the ticket is a document containing contractual terms
Non-ticket cases	If the contract is signed

CASE EXAMPLE

L'estrange v. F. Graucob Ltd [1934] 2 KB 394

Facts: The plaintiff agreed to purchase a machine, and she signed a contract. The contract contained several exemption clauses in small print that she failed to read.

Decision: The court held that she was bound by those clauses. It was immaterial that she did not read them.

CASE EXAMPLE

Olley v. Marlborough Court Ltd [1949] 1 KB 532

Facts: The plaintiffs were guests at a hotel run by the defendant. When they checked in, they paid for a week in advance and then went to the room allotted to them. On a wall was a sign stating: ' … the proprietors will not hold themselves responsible for articles lost or stolen, unless handed to the manageress for safe custody'.

The wife later left their room, hanging the key on a board at the reception desk. The key was stolen, the room was opened and her fur coats were stolen. The hotel sought to rely on the exemption clause to avoid liability.

Notice of clause to be provided before or at time contract is made

Decision: The court held that the hotel was liable for the loss. A contract had been completed at the reception desk, before Mr and Mrs Olley went to their room. No notice was given of the exemption clause before or at the time the contract was made. It was not given until after the contract was made, when they arrived at their room.

CASE EXAMPLE

Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd [1988] 2 WLR 615

Facts: A photographic transparency library was run by Interfoto. Transparencies were sent to Stiletto Visual Programmes (SVP) at their request. The transparencies were received with a delivery note. The delivery note indicated that a fee would be imposed for each day the transparencies were retained beyond a specified date. SVP did not read the conditions and failed to return the transparencies by the specified date. They subsequently received a bill that included a substantial fee for the late return of the transparencies.

Decision: As the clause had not been brought to the attention of SVP it did not form part of the contract. The penalty imposed by the clause was unreasonable. The court ordered SVP to pay only the reasonable costs of Interfoto.

Check your progress 9.1

Interactive version at www.mhhe.com/au/barron

Place a ticket in the appropriate box.

1. A statement made by one of the parties during contractual negotiations:
- (a) will never become a term of the contract ☐
- (b) may become a term of the contract ☐
- (c) will become a term of the contract ☐

2. The two broad categories of express terms of a contract are:
(a) warranties and implicit terms ☐
(b) conditions and written terms ☐
(c) conditions and warranties ☐

3. A term of a contract may be implied by the courts, by statute or by custom or trade usage.
(a) true ☐
(b) false ☐

4. A ticket containing an exemption clause will not form part of a contract unless a:
(a) reasonable person would regard the ticket as a receipt for payment ☐
(b) reasonable person would regard the ticket as containing contractual terms ☐
(c) reasonable person would regard the exemption clause as fair ☐

5. An exemption clause will be binding in 'non-ticket' cases if:
(a) the contract is signed ☐
(b) it is express and not implied in the contract ☐
(c) a reasonable person would consider the exemption clause as fair ☐

THE DOCTRINE OF PRIVITY OF CONTRACT

The common law doctrine of privity of contract provides that only the parties to a contract can sue or be sued on the contract. A person not a party to the contract cannot enforce or seek to enforce terms of the contract. This is so even if the contract is for this person's benefit.

Only parties to contract can sue and be sued

LAW IN ACTION

Alf agrees with Brad that Brad will perform work on property belonging to Charles. If Brad fails to meet his obligations under this contract, only Alf can sue Brad for breach of contract. Charles has no right to sue Brad as the doctrine of privity of contract states that only parties to a contract can enforce a contract. Charles is not a party to this contract, although it benefits him. Figure 9.2 illustrates the relationship between the parties in this example.

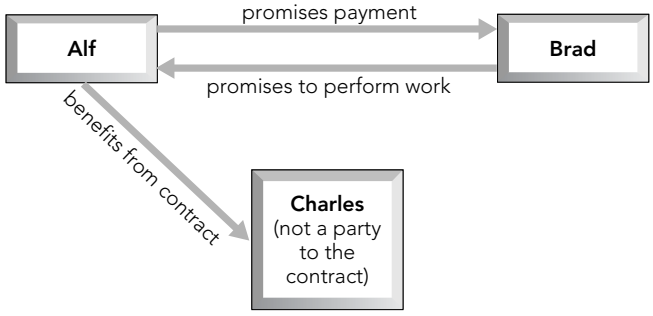

FIGURE 9.2 Application of the doctrine of privity of contract

Exceptions

There are exceptions to the doctrine of privity of contract. It does not apply to contracts of insurance. This is so at common law and pursuant to the *Insurance Contracts Act 1984* (Cwlth), discussed in Chapter 11. If it can be established that a contracting party entered a contract as agent for another person (a principal), then that other 'person' can enforce the contract. Another exception is where a contracting party can prove that it is acting as trustee for a third party.

Insurance contracts and trustees

Where a party assigns their rights and liabilities to another this will be an exception to this doctrine, as will a novation of contract (see p. xxx for a discussion of novation of contract).

Continuing operation of the doctrine

The doctrine of privity of contract has been firmly entrenched at common law since the decision of the House of Lords in *Dunlop Pneumatic Tyre Co. Ltd v. Selfridge Co. Ltd* [1915] AC 847. Viscount Haldane LC at 853 stated:

> ' … in the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it'.

Australian position

In a decision of the High Court of Australia, the importance of the doctrine of privity of contract was considered. The following case is important because of the comments made by a number of judges as to the value of the doctrine of privity of contract.

CASE EXAMPLE

Trident General Insurance Co. Ltd v. McNiece Brothers Pty Ltd (1988) 165 CLR 107

Facts: The defendant was the principal contractor for construction work carried out by Blue Circle Southern Cement Ltd. This company had an insurance contract with Trident whereby Trident agreed to provide insurance cover to Blue Circle (its subsidiary) contractors and suppliers, with respect to liability for personal injury. A workman was injured in circumstances allowing him to sue McNiece Brothers for negligence. McNiece sought indemnity from Trident, who denied liability as McNiece was not a party to the policy.

Decision: The court held that although the McNiece Brothers company was not a party to the original contract, it was entitled to be indemnified. The majority held that the doctrine of privity of contract did not apply to contracts of insurance. Mason CJ and Wilson J, in their judgments, stated that the established doctrine of privity of contract should be totally recognised, at least with respect to insurance contracts. Gaudron J said that she agreed with this view, but she made her decision without reference to the doctrine of privity. Toohey J conceded that the doctrine was not so firmly entrenched that it could not be changed. The remaining judges, Brennan, Dawson and Deane JJ, held the view that the doctrine was so entrenched in the law of contract that to change it would cause more problems than it was worth.

DISCHARGE OF A CONTRACT

Ending or terminating a contract

A contract is regarded as at an end or terminated when the word '**discharged**' is used. There are several circumstances that will result in the discharge of a contract. Figure 9.3 outlines the ways in which a contract is discharged.

- Performance of the contract
- Agreement between the parties
- Provision for discharge contained within the contract
- Discharge by operation of law
- Frustration of contract
- Breach of contract

FIGURE 9.3 Ways in which a contract may be discharged

Performance

If the parties to a contract perform the contract, it will be regarded as discharged.

EXAMPLE

Sue agrees with Ben to sell her Ford car to him for $5000. If Ben pays the sum of $5000 and Sue transfers possession of the car to Ben, the contract has been performed and is discharged.

Discharge following performance

Performance must correspond **exactly** with the terms of the contract in order for the contract to be discharged. If correspondence is not exact, one party to the contract will not have complied with its contractual obligations. The rule requiring exact performance can sometimes lead to unfair results, as indicated by the next case.

CASE EXAMPLE

Cutter v. Powell (1795) 6 TR 320; 101 ER 573

Facts: Cutter signed on as second mate on the ship *Governor Parry*, which was sailing from Jamaica. The contract provided that he was to be paid 30 guineas 'provided he proceeds, continues and does his duty … to the port of Liverpool'. Three-quarters of the way through the voyage, Cutter died. His widow sued to recover a proportion of the wages of 30 guineas.

Decision: Cutter's widow failed in her action. The court said that Cutter's contract was 'entire', meaning that he had to serve the full voyage before he became entitled to any part of the 30 guineas. As he had not performed the whole voyage (exact performance), his widow was not entitled to any payment.

Exceptions to exact performance requirement

The courts have developed a number of exceptions to the rule that performance must be exact. These exceptions overcome the harshness of the decision in *Cutter v. Powell*. The exceptions are as follows:

1. *Severable contracts.* Contracts can be classified as either 'entire', as was the case in *Cutter v. Powell*, or 'divisible' or 'severable'. Divisible or severable contracts are those where some performance, less than the whole contract, may confer rights on the party who has performed. Such contracts will often provide that payment will become due from time to time. Building contracts, where payments are made by instalments, are examples. Payment will be required after certain work is completed—for example, laying the slab and erecting the roof. In such contracts, if default is made part way through, the builder will not lose all rights. The builder is entitled to be paid for the work already completed.
2. *Substantial performance.* Where there has been substantial performance of an agreed obligation, the defaulting party may still be able to retain and enforce all the rights conferred by the contract. The courts will usually award to the innocent party an amount of damages as compensation for the fact that performance was not exact.

CASE EXAMPLE

Hoenig v. Isaacs [1952] 2 All ER 176

Facts: The plaintiff was engaged to redecorate and furnish the defendant's flat for £750, to be paid 'as the work proceeds and the balance on completion'. Only £400 was actually paid. The defendant refused to pay the balance on the grounds that the work had been poorly done and required rectification. The defendant claimed, when sued, that the contract was entire and, as it had not been performed as agreed, the plaintiff could not recover.

Decision: The court said that the work was partially defective but that the plaintiff had substantially performed what was required of him and the defects were easily remediable. The plaintiff was entitled to be paid the contract price less a reduction of £55 18s 2d, being the cost of the remedial work.

3. *Acceptance of partial performance.* If there has been a free and willing acceptance of partial performance of the contract, then it is permissible for the contract to be discharged if the party receiving the benefit is willing to accept something less than has been agreed.
4. *Obstruction of performance.* If one party is prevented from performing, the other party may regard the contract as at an end. The party that is prevented from performing is released from any further obligations pursuant to the contract.

Performance can take two forms: actual performance, or tender (attempted performance).

ACTUAL PERFORMANCE

Performance by payment of money

Performance can be by the payment of money. If money is to be paid, the creditor is entitled to be paid **legal tender**. Legal tender is the amount of money that a creditor is bound to accept in payment of a debt.

Limits on legal tender

Since the introduction of decimal currency, notes of any amount have been legal tender, but there is a limit with respect to coins. One dollar and $2 coins are legal tender for payment of an amount not exceeding ten times their face value. For $1 coins the amount will be $10 and for $2 coins it will be $20. Coins of the denominations 50 cents, 20 cents, 10 cents and 5 cents are legal tender for an amount not exceeding $5.

Distinction between absolute payment and conditional payment

Payment by legal tender or a bill of exchange

An **absolute payment** is one made by legal tender or where a bill of exchange is taken in absolute satisfaction of a debt. In contrast, a **conditional payment** is one made not in the form of legal tender—for example, payment by a bill of exchange or by a cheque. If payment is made in this way and the cheque or bill is not paid, then the acceptance of it is deemed conditional and the payee is placed in their original position under the contract, or the payee may sue on the cheque or the bill. If a party to a contract takes a bill of exchange or cheque in full discharge of an obligation and it is not paid, then that party should sue on the bill or cheque and not on the contract itself.

If a creditor takes a cheque or bill of exchange as absolute payment, then the creditor takes the risk of it being dishonoured. If the cheque or bill of exchange is dishonoured, then the creditor can sue only on the instrument and not on the contract.

Performance other than by the payment of money

Performance other than by the payment of money occurs when the parties perform mutual promises.

EXAMPLE

Ian agrees to mow Bob's lawn if Bob trims Ian's hedge. The performance of these acts by both parties would amount to performance of the contract and thus the contract would be discharged.

TENDER

Attempted performance

Tender is **attempted** performance where one party to the contract attempts to perform its obligations but the other party refuses to accept. If the attempt is made according to the terms of the contract and at a reasonable time and place, then a person's contractual obligations will be discharged (except the obligation to pay money). The contract will be regarded as discharged.

If the payment of money is the act that is required pursuant to the contract, payment will still be required. However, the debtor is not required to seek the creditor out to make the payment.

CASE EXAMPLE

Startup v. MacDonald (1843) 6 Man & G 593; 134 ER 1029

Facts: The plaintiff contracted to sell to the defendant 10 tons of oil to be delivered 'within the last 14 days of March'. The plaintiff finally attempted delivery at 8.30 pm on Saturday, 31 March. Because of the lateness of the hour, the defendant refused to accept and the plaintiff sued.

Decision: The defendant was liable to pay damages for non-acceptance. The tender had been valid and within the time provided. The plaintiff was under no further obligation to attempt delivery and could immediately sue for damages. His attempted delivery was equivalent in law to actual delivery.

Agreement between the parties

The parties to a contract can decide to terminate the contract. There are two main ways in which this can be done: agreeing to cancel the original agreement, or substituting a new agreement.

The parties may terminate a contract

CANCELLATION OF THE ORIGINAL AGREEMENT

The parties to a contract can terminate a contract by cancelling the original agreement.

Mutual discharge

The parties to a contract can mutually agree to end their contract. This is called mutual discharge and will only discharge the contract if both parties still have obligations to perform pursuant to the contract. No new agreement is entered if mutual discharge occurs.

Release

If one party to a contract has completed its contractual obligations and the other party has not, then the latter can be released from further performance. The release can be by an agreement under seal (deed) or by the party providing some further consideration for the promise to be released from further obligations. The consideration must be more than the party is already legally obliged to do.

Agreement under seal or provision of additional consideration

EXAMPLE

Michael agrees to mow Angela's lawns for $30. He completes the task but Angela fails to pay Michael the $30. Angela could be released from her obligation to pay the $30 by entering an agreement under seal (a deed) or by providing some further consideration for the promise to be released. Angela may promise Michael that she will wash his car. This promise will be sufficient to release Angela from her obligations.

Substitution of a new agreement

Parties can discharge a contract by replacing the original agreement with a new one.

Novation

Novation is one example of a method whereby a contract can be discharged and replaced by another contract. Novation is an agreement involving three parties. A contract between two parties is rescinded in consideration of a new contract being entered. The contract is between one of the parties and a third party. The terms of this contract are the same as those of the former contract.

Agreement involving three parties

A common example of novation is where a creditor agrees, at the request of the debtor, to allow another person to become the debtor in the place of the original debtor. The contract with the original debtor is now discharged.

EXAMPLE

Andrea owes Boris $50. Boris agrees with Andrea that Charles will become his debtor in place of Andrea. The contract between Andrea and Boris has been replaced by a contract between Charles and Boris. The contract between Andrea and Boris is regarded as discharged.

New agreement may be different from old agreement

If parties decide to substitute a new agreement, it is not always necessary that the new agreement be in the same form as the old agreement. A written contract can be replaced by a verbal contract. A verbal contract can be replaced with a written one. This is subject to the proviso that if a contract is required to be in writing, then the new contract must take that form.

Accord and satisfaction

New agreement with new consideration

This is another method of discharging a contract by creating a new contract. It is the release of one party from its obligations under a contract by the substitution of a new agreement with new consideration. The accord is the new agreement, whereas satisfaction is the new consideration. If a release, as discussed earlier, involves the giving of further consideration, then it will be called 'accord and satisfaction'.

One party agrees to discharge the other from its obligations pursuant to a contract. It agrees to accept something different from the other party. The consideration must be different from what the other party was already obliged to do in order for it to amount to satisfaction and discharge of contract.

The law has created several rules that state what will amount to new consideration. The payment of a smaller sum of money than is owing is not regarded as new consideration: it must be accompanied by a further promise.

EXAMPLE

Sue owes Clare the sum of $50. An agreement is made that Clare will accept the sum of $40 in full satisfaction of the debt. This will not amount to accord and satisfaction unless Sue does something else besides paying the money. If she agrees to pay the sum of $40 and wash Clare's car, then this would amount to accord and satisfaction and discharge the original agreement (i.e. the payment of $50).

Variation of method and time of payment

New consideration can be a different method of payment of an amount owing. For example, an agreement whereby payment was to be made by cheque can be replaced with an agreement to pay cash. Payment at a time earlier than agreed can amount to new consideration sufficient to discharge an original agreement.

It should be noted that once accord and satisfaction exist, then a new binding agreement is created between the parties. It would not be possible for one of the parties to try to renege on the new agreement. The doctrine of promissory estoppel would prevent a party from doing so. This doctrine was explained and discussed in some detail in Chapter 7.

Contract itself contains provision for discharge

A term of a contract may provide for the discharge of the contract in certain circumstances. These terms fall into two main groups: options to terminate and conditions subsequent.

OPTIONS TO TERMINATE

Many contracts will contain terms that give one or both of the parties the option to terminate the contract and therefore discharge it.

Contracts of employment

Contracts of employment contain an option to terminate. An employee is given the right to terminate their contract of employment. Usually such a right will be subject to the requirement of giving a period of notice. The length of notice will depend on the contract in question. An employer also has the right to terminate a contract, but this right is more limited than the employee's right. Termination can occur only if there has been a breach of the agreement or if another cause exists. Employment law is discussed in some depth in Chapter 21.

Conditions subsequent

Conditions subsequent are terms of a contract that allow a contract to be brought to an end on the happening of a certain event or condition. These conditions were discussed earlier in this chapter.

Discharge by operation of law

Wishes of parties are overridden

A contract can be discharged irrespective of the actions of the parties. Operation of the law will discharge a contract in the following circumstances. These circumstances will override any wishes of the parties.

BANKRUPTCY

A person who is obligated to pay money pursuant to a contract and becomes bankrupt pursuant to the *Bankruptcy Act 1966* (Cwlth) is relieved from their obligations. The law regards the contract as discharged. The reasons for this are discussed in Chapter 20.

MATERIAL ALTERATION

Material alteration without consent of other party

Where one party to a written contract makes a material alteration to the terms of the contract without the consent of the other party, then this other party has a right to regard the contract as discharged. The alteration must be **material** (i.e. important or significant). This rule applies to written contracts only.

CASE EXAMPLE

Birrell v. Stafford [1988] VR 281

Facts: A guarantee document was executed and witnessed in Melbourne. The document was sent to Adelaide by the lending bank. In Adelaide, the bank manager substituted his own signature for that of the Melbourne witness and the word 'Adelaide' was placed in the document as the place of execution. The date of execution was also altered.

The bank subsequently sought to enforce the guarantee but received payment from only one guarantor. Birrell, the guarantor who had paid, sought contribution from Stafford who was a co-guarantor. Stafford argued that he was not under any legal obligation to pay pursuant to the guarantee document because the bank's alterations amounted to a material alteration of the document and it was therefore void.

Decision: The court said the question the court had to decide was whether the instrument, as altered, would have a different operation from that of the instrument in its original condition? The court held that if would not. None of the amendments changed the effect of the guarantee at the time of its formation.

MERGER

Simple contract replaced by deed

By operation of the law, a **merger** occurs where a right is extinguished because it coincides with or is incorporated into a greater right. Applying this to contracts, if a simple contract in writing is replaced by a deed (a higher form of contract) then the simple contract is said to merge in the deed. The simple contract no longer exists and it has been discharged by merger (i.e. by all its terms being incorporated in the deed). This will only occur if the deed is made between the same parties and is on the same terms.

Interactive version at www.mhhe.com/au/barron

Check your progress 9.2

Place a tick in the appropriate box.

1. The doctrine which provides that only the parties to a contract can sue or be sued on the contract is called the:
- (a) doctrine of the separation of powers ☐
- (b) doctrine of privity of contract ☐
- (c) doctrine of legality of contract ☐

2. The blue pencil test allows:
- (a) contracts without consideration to be valid ☐
- (b) contracts to be enforced despite the fact that the contract has been entered because of duress ☐
- (c) illegal terms to be removed from a contract in order to enforce the contract ☐

3. An attempt by one party to perform their obligations under a contract where the other party refuses to accept the attempt to perform is called:
- (a) tender ☐
- (b) actual performance ☐
- (c) notional performance ☐

4. When a contract is discharged and replaced by another contract, this is an example of:
- (a) the doctrine of replacement ☐
- (b) novation of contract ☐
- (c) release ☐

5. A contract can be discharged irrespective of the actions of the parties.
- (a) true ☐
- (b) false ☐

6. A party can be released from their obligations under a contract if:
- (a) the parties to the contract mutually agree to end their contract ☐
- (b) one party to the contract has completed their obligations but the other has not ☐
- (c) one party has attempted to perform their obligations but failed ☐

7. Accord and satisfaction refer to a:
- (a) remedy for frustration of contract ☐
- (b) form of consideration ☐
- (c) method of discharging a contract by creating a new contract ☐

Frustration of contract

Contract incapable of being performed

Another method whereby a contract can be discharged is by the operation of the doctrine of frustration of contract. Put simply, 'frustration' means the **impossibility of performance** of a contract. A good definition of frustration is provided by Lord Radcliffe in *Davis Contractors Ltd v. Fareham UDC* [1956] AC 696 at 729:

> 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.

Requirements that must be satisfied

It is possible to divide the above definition into several parts. All parts must be present before a contract can be discharged by frustration. They are set out in Figure 9.4.

- An event that is unforeseen must occur.
- The occurrence of the event must not be the fault of either party.
- The frustrating event must occur after the contract has been made.
- The frustrating event must make performance of the contract radically different from what was agreed by the parties.

FIGURE 9.4 Key elements of frustration

Destruction of subject matter

If the subject matter of the contract is destroyed after the contract is made, through no fault of either party, then the contract will be frustrated.

LAW IN ACTION

Geoff agrees with Victor that he will rent his flat to Victor for a period of six months. If, after the contract is made, through no fault of either party, the flat were to be destroyed by fire, then the contract would be frustrated. It is impossible to perform the contract (i.e. to rent a flat that had been destroyed).

CASE EXAMPLE

Taylor v. Caldwell (1863) 32 LJQB 164

Facts: A contract was entered to use the Surrey Gardens and Music Hall for a period of four days. The hall was destroyed by fire before the contract could be performed.

Decision: The contract had been frustrated by the destruction of the subject matter—the hall.

If the subject matter of a contract is destroyed prior to the contract being made—for example, at the offer and acceptance stage—this will not be frustration of contract because no contract exists. It will be a case of common mistake.

EXAMPLE

Sarah agrees to sell her Honda car to Amanda. At the time they make the contract, both believe the car is in a carpark. However, shortly before the contract is negotiated, the car is destroyed when a fire guts the carpark.

The above example is a case of common mistake as opposed to frustration of contract.

Failure of an event to take place

Events fundamental to contract

Sometimes the performance of a contract is dependent on the happening of a particular event. If the event is fundamental to the contract, and the event fails to take place, then the contract may be frustrated.

CASE EXAMPLE

Krell v. Henry [1903] 2 KB 740

Facts: A flat that was to be on the procession route for the coronation of Edward VII was rented for two specific days. The procession was postponed and the lessee refused to pay the rent.

Decision: The court held that the lessee was not obliged to pay. The contract had been frustrated by the postponement of the coronation. The only reason for hiring the room was to see the procession. If this did not take place, because the coronation did not take place, then the contract was impossible to perform.

Performance rendered pointless

The principle established in *Krell v. Henry* is a narrow one. It will not apply unless performance of the contract has been rendered 'pointless' by the event relied upon. This point is well illustrated by the next case, which also concerned the coronation of Edward VII.

CASE EXAMPLE

Herne Bay Steamboat Co. v. Hutton [1903] 2 KB 683

Facts: The plaintiff company hired a boat to Hutton so that Hutton could view the naval review at the coronation of Edward VII and cruise around the fleet. The review was cancelled but the fleet was still assembled. The issue was whether the cancellation of the review frustrated the contract.

Decision: The contract was not frustrated by the cancellation of the review. It was still possible for Hutton to cruise around the fleet as the fleet was still assembled. The court said that performance of the contract had not been rendered pointless.

Contract of personal services

Performance of a particular task

A contract of personal services is a contract whereby a person will perform a particular task. If the person is unable to perform the task because of illness or death, the contract is regarded as frustrated.

EXAMPLE

If a person is engaged to sing at a concert but illness makes it impossible for the person to perform, then the contract would be frustrated.

Change in law

A change in the law may result in a frustrated contract.

CASE EXAMPLE

Czarnikow Ltd v. Rolimpex [1979] AC 351

Facts: The defendant, a Polish marketing authority, contracted to sell to the plaintiff company 17 000 tonnes of beet sugar. Before delivery was made, the Polish government banned all sugar exports. Czarnikow Ltd claimed that there had been a breach of contract.

Decision: The court held that the change in the law had frustrated the contract. This change was beyond Rolimpex's control, and therefore there was no breach of contract.

Government interference

Government interference may frustrate a contract, even though there has been no actual change in the law.

CASE EXAMPLE

Metropolitan Water Board v. Dick, Kerr & Co. Ltd [1918] AC 119

Facts: In 1914 the defendant company agreed to construct a reservoir to be completed within six years. In 1916 the ministry of munitions ordered the company to cease work. The labour force was diverted to a munitions factory to assist with the war effort. The plaintiffs contended that the contract to build the reservoir still stood.

Decision: The court held that the contract was frustrated by the order of the government. The interruption was such that it made performance of the contract (if it resumed) different from what was originally agreed. At the time the case was heard, the project had been delayed for two years. It was therefore impossible to perform the original agreement to complete the project in six years.

An increase in the burden of performance

Frustration may result from an increase in the burden of performance

An event that increases the burden of performance placed on one party to a contract may be sufficient to discharge the contract on the basis of frustration. The following case illustrates this point.

CASE EXAMPLE

Codelfa Construction Pty Ltd v. State Rail Authority of New South Wales (1982) 149 CLR 337

Facts: Pursuant to a building contract, the contractors agreed to excavate tunnels for the Eastern Suburbs Railway project. They intended to work three shifts per day, six days a week. Local residents were unhappy about the work hours and obtained an injunction that prevented the contractors from working as intended. As a result of the injunction, the work was delayed and the burden of performance on the contractors was increased greatly. This was because there was no right under the contract for payment for the contractors' increased expenses.

Decision: The contract was capable of being frustrated by the events that had occurred. The court did not finally decide if the contract was in fact frustrated. They referred the decision to an arbitrator to make a final determination.

EFFECT OF FRUSTRATION

Contract terminated and discharged

Once a frustrating event has happened, a contract is terminated and discharged. The whole contract is brought to an end. If money has been paid pursuant to a frustrated contract, generally the money can be repaid. This is the case if there has been a total failure of consideration (i.e. no part of the contract, and no consideration, has been effected).

Figure 9.5 illustrates the reasons a contract may be frustrated and the effect of frustration.

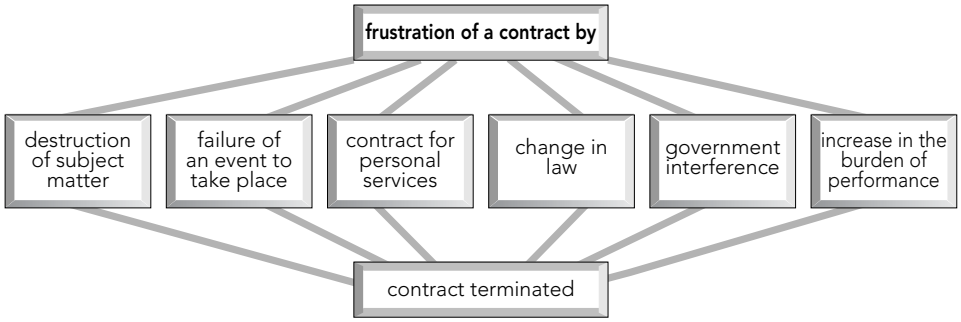

FIGURE 9.5 The reasons a contract may be frustrated

EXAMPLE

A hall is booked for a wedding reception and a deposit of $200 is paid at the time of making the contract. If, at a later time, the hall is destroyed by fire before the reception can be held, the deposit will be recoverable.

This rule may be unfair where the party repaying money has performed some work preparatory to carrying out the contract. For example, a party may have manufactured an item of machinery to satisfy a contract.

CASE EXAMPLE

Fibrosa S. A. v. Fairbairn, Lawson, Combe, Barbour Ltd [1943] AC 32

Facts: Fairbairn contracted to supply Fibrosa (a Polish company) with a number of textile machines to be delivered at Gdynia. The total price was £4800, of which £1000 was paid in advance. Before delivery could be made, war broke out and the Germans occupied Gdynia. The contract was thus frustrated and Fibrosa sued to recover its £1000.

Decision: Fibrosa was entitled to the return of its money. The court said that there had been a total failure of consideration, and money paid was therefore recoverable.

STATUTES DEALING WITH FRUSTRATION

Modification of common law

The doctrine of frustration of contract is a common law doctrine. However, in some jurisdictions, statutes that modify the common law have been passed. They include:

- Victoria *Frustrated Contracts Act 1959*
- New South Wales *Frustrated Contracts Act 1978*
- South Australia *Frustrated Contracts Act 1988.*

Features of statutes

These statutes have common features. Certain contracts are excluded from the operation of the Acts. They include contracts of insurance, contracts for the carriage of goods by sea or contracts to a charter party (with some exceptions). Another common feature is that they all apply under the relevant sale of goods Acts to a contract for the sale of goods, avoided because the goods have perished before the 'property' in goods has passed to the buyer.

The statutes also differ in many respects. We will consider each statute briefly.

Victoria: *Frustrated Contracts Act 1959*

Money paid prior to frustration

All sums that have been paid prior to frustration are recoverable. This modifies the common-law requirement of a total failure of consideration. This Act only applies if there is a claim to recover money paid prior to frustration. The court is permitted to order payment of a sum for expenses incurred by the other party to the contract. This sum cannot exceed the money paid by the other contracting party.

If a party has received a valuable benefit, the court will allow the other party to recover a sum that the court considers just, having regard to the circumstances of the case.

New South Wales: *Frustrated Contracts Act 1978*

This Act is similar to the Victorian Act. It provides for recovery of an amount paid prior to frustration. It also provides for the payment of one-half of the reasonable costs incurred by a party for the purpose of performing the contract.

The court has power to exclude the operation of the Act. This will occur when an adjustment in accordance with the Act would be inappropriate or inadequate. The court then has power to make a suitable order for adjustment.

South Australia: *Frustrated Contracts Act 1988*

Action for breach of contract may be initiated

This statute adopts a different approach from the other two. The Act provides that frustration discharges a contract but a party may still have an action for breach of contract in respect of breaches *prior* to frustration. Adjustment of parties' rights after frustration are calculated in the following ways:

1. The value of benefits received is assessed and aggregated.
2. The value of contractual performances is assessed and aggregated.
3. The aggregate of the value defined in 2 (above) is subtracted from the value of 1 (above) and the remainder is divided between the parties equally.
4. An adjustment is made between the parties so that there is an equalisation of the contractual return of each at the figure in 3 (above). If a court believes that a more equitable basis for adjustment exists, adjustment may be made on a different basis rather than by applying the above formula. Contractual benefits must be taken into account when valuing the benefits.

Breach of contract

Failure to fulfil contractual requirements

Breach of contract occurs when a party fails to fulfil a term of a contract or all contractual obligations. Certain breaches of contract will result in the other party being discharged from its obligations. The contract will be regarded as discharged.

A breach of contract may occur before performance of some or all of a party's contractual obligations. This is called an **anticipatory breach.** A breach occurring once the contract has commenced is called an **actual breach**.

ANTICIPATORY BREACH

Repudiation of the contract

An anticipatory breach of contract occurs when one party, before fully completing its obligations pursuant to a contract, indicates it is not going to complete its remaining obligations. The term used to describe these actions is **repudiation**. The contract is said to have been repudiated.

Rights of injured party

The innocent party does not have to wait for the threatened breach to occur. If one party advises the other that they wish to terminate the contract, the other party can regard the contract as discharged. The injured party does not have to wait till a threatened breach becomes an actual breach.

CASE EXAMPLE

Foran v. Wight (1989) 64 ALJR 1

Facts: Vendors and a purchaser entered into a contract for the sale of land. The purchaser paid a deposit. Settlement on a particular date was an essential condition contained in the contract. Subsequently, the vendors determined that they were unable to settle on the date specified in the contract. Before the relevant date the vendors informed the purchaser that they wished to settle at a later date. The purchaser did not attempt to settle on the date specified in the contract. Several days later the purchaser sought to recover the deposit from the vendor. The vendor refused to return the deposit and alleged that the purchaser had breached the contract by failing to settle on the date specified in the contract.

Decision: The High Court of Australia found that the notice given by the vendors amounted to an anticipatory breach of the contract. The vendors were guilty of a breach of contract, which freed the purchaser from the requirement to pay the balance of the purchase price on the date specified in the contract.

CASE EXAMPLE

Gold Coast Oil Pty Ltd v. Lee Properties Pty Ltd [1985] 1 Qd R 416

Facts: There was an agreement between the owner of land and a company for the lease of premises. The lease was to commence from the date of the completion of building alterations by the lessee. Before completion of this work, the lessee indicated that the alterations would not go ahead until economic conditions became more favourable.

Decision: This conduct was held to amount to anticipatory breach.

CASE EXAMPLE

Hochster v. De La Tour (1853) 2 El & Bl 678; 118 ER 922

Facts: The defendant engaged Hochster in April to act as courier, the appointment to take effect from 1 June. Three weeks before the date of commencement of the contract, De La Tour wrote to Hochster advising him that his services were no longer required.

Decision: The court held that this amounted to an anticipatory breach of contract by the defendant, entitling the plaintiff to damages for breach of contract.

RENUNCIATION DURING PERFORMANCE

Refusal to complete obligations under contract

It is possible that a contract has been partially performed when one party repudiates it. This will occur when one party refuses to complete its obligations under the contract. If this occurs, the other party can treat the contract as discharged.

CASE EXAMPLE

Cort v. Ambergate, Nottingham & Boston & Eastern Junction Railway Co. (1851) 17 QBR 127

Facts: The plaintiffs agreed to supply the defendants with a large number of railway chairs to be delivered in certain quantities on certain dates. After some of the chairs had been delivered, the defendants refused to take any more. The plaintiff sued for breach of contract.

Decision: The court said that where there is an executory contract for the manufacture and supply of goods from time to time, to be paid for after delivery, if the purchaser, having accepted and paid for a portion of the goods, gives notice to the seller not to manufacture any more as they will not be accepted, then the seller is entitled to bring an action for breach of contract without the necessity of manufacturing and tendering any more goods.

IMPOSSIBILITY OF PERFORMANCE

Repudiation and discharge

If one party makes it impossible for a contract to be performed, this will amount to a repudiation of the contract and the contract will be discharged. The impossibility may be created by one party before the contract is due to be performed or during the performance of the contract. An example would be where a person promises, in a contract, to transfer property to another, and before the contract can be performed, the person sells the property to someone else. As the person is no longer the owner of the property, the original contract has become impossible to perform.

This idea of impossibility of performance should not be confused with frustration of contract. Frustration is also an impossibility of performance but it is neither party's fault. Frustration of contract is as the result of an unforeseen event that makes performance impossible.

ACTUAL BREACH

Rescission of contract

An actual breach is a breach of a term of a contract. This may amount to a breach of contract, enabling the injured party to rescind the contract. It depends on the nature of the term that is breached. A breach of a condition entitles the injured party to terminate the contract and sue for damages. A breach of a warranty will not terminate the contract but it will enable an injured party to sue for damages. Earlier in this chapter we discussed how to determine if a term is a condition or a warranty.

TABLE 9.4 Remedies for anticipatory breach and actual breach

Type of breach	Remedy
Anticipatory breach	Terminate contract (rescission)
	Damages
Actual breach	For breach of condition:
	Terminate contract
	Damages
For breach of warranty:	No right to terminate contract (rescission)
	Damages

REMEDIES FOR BREACH OF CONTRACT

If a party breaches a contract, the other party will be entitled to a remedy as compensation. There are a number of remedies for breach of contract. Figure 9.6 provides an overview of the remedies we will discuss.

Right to rescind

Contract set aside

Rescission of contract entitles a person to set aside a contract. The person is restored to the position they were in before the contract was made. A right to rescind for breach of contract will

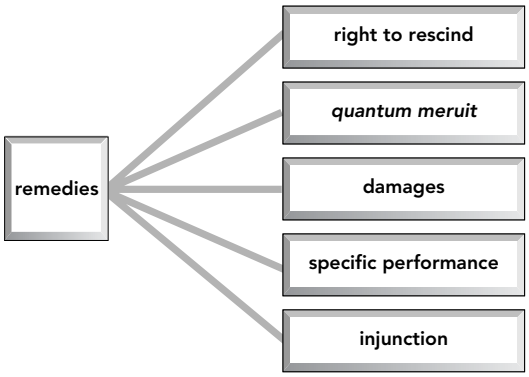

FIGURE 9.6 The remedies for breach of contract

only be available if there is a breach of a **condition**. A breach of **warranty** will not give the injured party a right to rescind, only a right to an action for damages. A party's right to rescind will be lost in certain circumstances. These include:

- where a party, after a breach, takes some action to affirm the contract
- where a third party, acting in good faith, acquires a right in the subject matter of the contract (e.g. a breach of contract has occurred and before the injured party has exercised its right to rescind, a third party, unaware of the breach, has purchased the subject matter of the contract)
- where it is impossible to restore the parties to their precontractual positions.

Quantum meruit

Damages for part performance of contractual obligations

Where one party has fulfilled part of its contractual obligations and the other party breaches the contract, it may be appropriate for the injured party to seek the remedy of ***quantum meruit***. The literal translation of this Latin term is 'for as much as he has earned'.

The remedy is available to a party that has performed part of a contract and the law says that this party should receive something for the work performed. The amount will reflect the amount of work that has been done (i.e. 'for as much as he has earned'). The rationale for this remedy is that a party that has benefited from the contract being partly performed should have to pay a reasonable price for the benefit enjoyed. Figure 9.7 sets out the circumstances in which the remedy of *quantum meruit* can be applied.

- Where one party prevents the injured party from fulfilling their contractual obligations
- Where the parties dispute the amount to be paid
- Where the parties dispute whether there should be a payment at all

FIGURE 9.7 Circumstances when the *quantum meruit* remedy can be applied

CASE EXAMPLE

Pavey and Matthews Pty Ltd v. Paul (1987) 162 CLR 221

Facts: Pursuant to an oral contract, a builder commenced work. Subsequently the customer sought to avoid paying for the work done. He sought to rely on the terms of a statute that stipulated that oral contracts could not be enforced. The builder claimed damages on a *quantum meruit* basis for work done.

Decision: The High Court of Australia found that the customer had obtained the benefit of the builder's work and therefore the builder was entitled to damages for the work he had carried out.

CASE EXAMPLE

Planche v. Colburn (1831) 8 Bing 14; 131 ER 305

Facts: Planche was engaged by a company to write a book, to be published by instalments in a weekly magazine. After a few instalments had appeared, the magazine was abandoned and the plaintiff sued on a *quantum meruit*.

Decision: The plaintiff was entitled to recover on a *quantum meruit* for the work he had done under the contract.

Damages

Aim of damages

The award of damages as a remedy for breach of contract is an award of a sum of money to the injured party. The aim of damages is to compensate a person who has suffered loss because of a breach of contract. It aims to put the parties into the position they would have been in had the contract been performed. The article below provides an example of a claim for damages arising from the breach of a contract. A loss must be suffered before a party will be entitled to damages.

Damages can be divided into three main categories, as set out in Table 9.5.

TABLE 9.5 Main categories of damages

Category	Description
Ordinary damages	Also called real damages. These represent an amount of money that reflects the actual loss sustained
Nominal damages	Are an award of a nominal or small amount of damages (e.g. an award of $1). This award is an acknowledgment by the court that a legal right has been infringed but that no actual loss has been suffered
Exemplary damages	Also called punitive damages. These damages do not aim to compensate but to punish or make an example of a party. They will not reflect the actual loss that has been suffered

The aim of damages is to place the injured party in the position it would have been in had the contract been carried out as agreed. There are several rules regarding the amount of the damages and method of calculating the damages payable because of a breach.

Boxing

Tyson's court battle: Mike Tyson began his latest courtroom fight in Albany, New York—his former trainer is suing him for $12.7 million, alleging breach of contract. Kevin Rooney filed the suit against the heavyweight eight years ago, but jury selection has just begun in the US District Court. Rooney claims Tyson's late mentor, Cus D'Amato, promised him 10~per cent of Tyson's winnings for as long as he fought.

Source: The *Age*, 19 September 1996, p. 7, Sport Section.

Newspaper discussion questions

1. What is the basis for the alleged breach of contract?
2. Identify the remedy being sought.
3. Outline any differences that might exist if this case had arisen in Australia rather than the United States.

Damages payable only for a foreseeable loss

Loss must not be too remote

A party is not entitled to receive damages for a loss that is too remote. Damages will be payable for a loss that both parties regard as **reasonably foreseeable** in the event of a breach of contract. Damages are payable for losses that would ordinarily flow from the breach.

CASE EXAMPLE

Hadley v. Baxendale (1854) 9 Ex 341

Facts: A crankshaft in a mill broke and, as a result, the mill could not operate. The mill owner entered a contract with a carrier to take the broken part to a manufacturer who could use it as a pattern to make a new crankshaft. The carrier undertook to deliver the part the following day. He failed to honour his promise and this amounted to a breach of contract. The plaintiff mill owner had not informed the carrier of the urgency of the matter. The carrier was not informed that the mill could not operate until the crankshaft was repaired. The mill owner sued the carrier for loss of profits resulting from the period that the mill was idle owing to the carrier's delay.

Damages must be reasonably foreseeable

Decision: The court held that the damages representing the loss of profits could not be recovered as this loss had not been caused by the defendant. The damages were too remote, the reason being that the defendant, at the time of contracting, could not have foreseen that his breach of contract would bring about the damages in question.

CASE EXAMPLE

Commonwealth v. Amann Aviation Pty Ltd (1991) 104 ALR 1

Facts: Amann entered into a contract with the Commonwealth, agreeing to provide aerial surveillance over Australia's northern coastline. It was anticipated that Amann would require six months to purchase and equip aircraft so that they would be suitable for the surveillance operations. The purchase and modification costs fell to Amann. Amann failed to have the aircraft ready to perform the first of the surveillance flights. The Commonwealth sought to terminate the contract, alleging that Amann had breached the contract. However, under the terms of the contract, the Commonwealth was required to provide Amann with an opportunity to show why the contract should not be terminated.

Following the commencement of litigation, it was agreed that the Commonwealth had failed to properly terminate the contract. The High Court of Australia was required to determine the extent of, and basis upon which, an assessment of damages should be made.

Decision: The Court found that Amann had incurred large expenses in anticipation of the contract being fulfilled. The company was entitled to be compensated for the expenses they had incurred in reliance of the contract. Amann was awarded over $6 million in reliance damages relating to the cost of acquiring and modifying the aircraft. The High Court of Australia found that the damages sought by Amann were not too remote.

CASE EXAMPLE

Baltic Shipping Co. v. Dillon (The *Mikhail Lermontov*) (1993) 176 CLR 344

Facts: Dillon was the passenger on a cruise ship that sank near New Zealand. Dillon sued Baltic Shipping, claiming damages for disappointment and distress.

Loss must be directly linked to a breach of contract

Decision: The High Court of Australia found that Dillon was entitled to damages for the disappointment and distress she had suffered. The Court recognised that it is usually the aim of such travel contracts to provide pleasure and relaxation. Baltic Shipping had failed in this regard and the loss suffered by Dillon was directly linked to this breach of the contract.

CASE EXAMPLE

Victoria Laundry (Windsor) Ltd v. Newman [1949] 2 KB 528

Facts: The defendant company contracted to sell a large boiler to a laundry operated by the plaintiff company. Delivery was to be made on 5 June but was not made until 8 November. The plaintiffs sued for damages because of the delay.

Claims were made by the plaintiffs regarding two specific losses. First, a claim for damages was made for loss of profits incurred by the plaintiff company in its general laundry business as a result of not having the boiler. The second claim was for damages for loss of lucrative dyeing contracts that could have been made with a government department had the boiler been received in time.

Decision: The court held that the plaintiff company was entitled to claim the first amount of damages as the loss flowed directly from the breach of contract.

The plaintiffs failed in their second claim. The court held that the loss was too remote. It would not have been foreseeable. The defendants had no knowledge of the dyeing contracts and therefore were unable to foresee a loss in respect of same.

Actual and future loss

A party is entitled to claim damages for actual loss and future loss. This is subject to the proviso that a future or prospective loss can be quantified. Damages are not restricted to compensating loss of a financial nature. Damages can be awarded for mental anguish or distress.

CASE EXAMPLE

Jackson v. Horizon Holidays Limited [1975] 1 WLR 1468

Facts: The plaintiff booked holiday accommodation with the defendant. The plaintiff did not receive the standard of accommodation required.

Decision: The plaintiff was entitled to claim damages for distress caused when holiday accommodation received was inferior to that promised by the contract. Lord Denning MR at 1472 said that the plaintiff was entitled to damages for 'mental distress, inconvenience, upset, disappointment and frustration caused by the loss of the holiday'.

Duty to mitigate

Loss must be minimised

Parties are under an obligation to keep their losses to a minimum. The law calls this a duty to 'mitigate their loss'.

LAW IN ACTION

A contract is made by Eric to rent his house to Pamela for $300 per month for a period of six months. Pamela breaches her contract before performance is made. Eric's loss is six months' rent at $300 per month, a sum of $1800. Eric is entitled to sue Pamela for breach of contract, but he is also under a duty to mitigate or reduce his loss. He would breach this duty if he failed to take any steps to find another tenant. He would be required to advertise and make attempts to find a suitable tenant. It may take him a while—say, two months. If this is the case, he will be entitled to damages from Pamela for the loss of two months' rent (i.e. $600).

Measure of damages

A person who has been injured as a result of a breach of contract is entitled to a sum of money that will put them in the position they would have been in had the breach of contract not occurred. The measure of damages for a breach of contract will be the difference between the contract price and the market price.

EXAMPLE

Daphne agrees to purchase a pine table from Vince for $250. Vince refuses to transfer possession of the table and is in breach of contract. Daphne is unable to purchase an equivalent table for less than $275. Her damages would be the difference between the market price ($275) and the contract price ($250), a sum of $25.

CASE EXAMPLE

Radford v. de Froberville [1978] 1 ALL ER 33

Facts: Radford owned a block of apartments. He sold a block of land adjoining his property to de Froberville. Radford specified that de Froberville must build an expensive brick wall in accordance with Radford's specifications. Before the wall was built de Froberville sold the property to another person.

Radford sued De Froberville for breach of contract. De Froberville argued the measure of damages should be the decrease in value to Radford's property as a result of the fence not being built.

Decision: The court disagreed with de Froberville's argument. The court held that Radford was entitled to such damage as would put him in the position he would be in had the breach of contract not occurred. He was entitled to the cost of constructing a wall such as that which had been specified in the contract.

Liquidated damage

Amount to be paid is specified

If a contract contains a term that specifies the amount to be paid in the event of a breach of contract, and this is a genuine pre-estimate of the loss in the event of a breach, then the damages are said to be **liquidated**. If the amount of damages payable in the event of a breach is not stated in the contract, the damages are said to be **unliquidated**.

Penalty clauses

Deterring breaches of contract

Sometimes a clause is included in a contract to deter a person from a breach of contract. A clause will state the amount payable in damages should a breach occur. However, if a clause states an amount to be paid that is out of proportion with the greatest possible loss that could flow from a breach—that is, the clause states an exaggerated amount, it will be classified as a **penalty clause**.

The courts will ignore penalty clauses and award damages that compensate for a loss. Whether a clause is regarded as a penalty or as liquidated damages will depend on the facts of each case. In *Public Works Commissioner v. Hills* [1906] AC 368, Lord Dunedin, at 375–6, said that the determination by the court as to whether a clause is a penalty will be

> found in whether the sum stipulated for can be regarded as a genuine pre-estimate of the creditor's probable or possible interest in the due performance of the principal obligation.

EQUITABLE REMEDIES

Alternatives to damages

Damages are a common-law remedy. They will not always be appropriate as compensation for a breach of contract. The law of equity provides other remedies that may be claimed when damages are inadequate. These remedies include an action for specific performance, and an injunction.

Specific performance

Where damages cannot adequately compensate

An order for 'specific performance' is a court order that demands that a person in breach of contract specifically perform their obligations under the contract. This remedy is only available if damages cannot adequately compensate the injured party. It is most often awarded with respect to contracts for the sale of land or for the purchase of rare or unusual items. It would be appropriate to claim specific performance in the following circumstances.

LAW IN ACTION

Diana makes a contract to purchase an original painting by a well-known artist for the sum of $40 000 from Ian. Ian refuses to part with the painting. Paying Diana damages will not adequately compensate her, as she is unable to purchase this item elsewhere. An original painting is a rare item, and the appropriate remedy is specific performance. A court can order Ian to perform his part of the contract (i.e. to hand over possession of the painting).

The courts will not make an order for specific performance in the type of circumstances set out in Figure 9.8.

- Where the court is unable to supervise an order
- Where damages are adequate compensation
- Where an employment contract is involved
- Where the contract lacks consideration (e.g. a deed)
- Where it would be unfair or harsh to either party
- Where a contract requires personal performance

FIGURE 9.8 Circumstances under which specific performance will not be granted

Injunction

Preventing a person from performing an act

An 'injunction' is a court order that prevents a person from performing or continuing to perform a particular act. It is a remedy that equity provides to a person who cannot be adequately compensated by an award of damages. Figure 9.9 illustrates what an injunction may prohibit a person from doing.

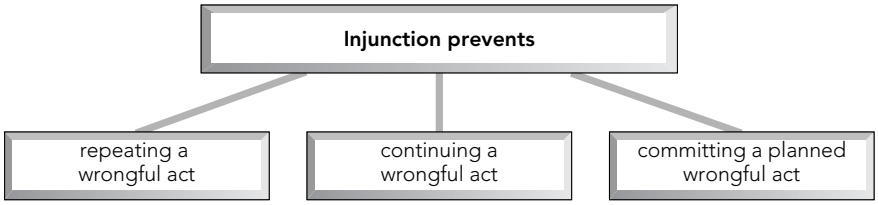

FIGURE 9.9 The restrictions imposed by an injunction

CASE EXAMPLE

Warner Brothers Pictures v. Nelson [1937] 1 KB 209

Facts: The defendant was a well-known film star. She contracted for one year to provide her exclusive services to Warner Brothers. She agreed not to render services to any other person during the term of her contract. When she entered another contract to perform for another party, an injunction was obtained to prevent her from doing so.

Decision: The court held that damages were not an appropriate remedy. The court gave the plaintiff an injunction.

Injunctions granted in a number of circumstances

Injunctions are awarded not only as a remedy for breach of contract. In family law disputes, a party is often prevented, by an injunction, from selling or otherwise dealing with matrimonial property, pending a resolution of a property settlement dispute.

LOSS OF RIGHTS TO SUE FOR BREACH OF CONTRACT

Statutes of limitation

A person may lose their right to sue for a breach of contract unless they act within a certain period of time. Statutes of limitation in each State and Territory limit the periods in which legal proceedings may be taken to enforce a right under a contract. These statutes aim to prevent the possibility of litigation continuing indefinitely. The rules can be summarised as follows:

- In the case of simple contracts, actions must be brought within six years from the date the cause of action arose (three years in the Northern Territory).
- In the case of contracts under seal (deeds), the time differs from State to State: twelve years in New South Wales, Queensland and Tasmania; fifteen years in Victoria and South Australia; and twenty years in Western Australia.
- Once the time limit expires, a person is barred by statute from taking proceedings. The debt is still owing and payable but no proceedings can be issued in a court seeking its recovery.

SPECIALITY CONTRACTS

We have spent most of Chapters 7, 8 and 9 discussing the elements needed to form a valid contract. We will now consider some special types of contract that are commonly encountered in the world of business. Most of these contracts are not discussed in detail below as they are dealt with elsewhere in this book. Examples of speciality contracts are a lease, a hire purchase agreement and a franchise agreement.

A lease

Exclusive possession of property

A 'lease' is a type of contract. It involves one party granting exclusive possession of property to another party for a period of time. The term is usually reserved for land, and the party granting the lease is termed the lessor or landlord. The party enjoying the benefit of the lease is called the lessee or tenant. It is usual for the lessee to pay rent to the lessor as consideration for the lease.

We will not discuss the features of a lease in any further detail, as they will be discussed in Chapter 10.

A hire purchase agreement

This is another specific type of contract. A 'hire purchase agreement' is where the owner of goods hires the goods in exchange for regular payments. After all payments have been made, the hirer becomes the owner of the goods.

In some States, the concept of a hire purchase agreement has been abolished. Note that in Western Australia hire purchase legislation still applies to non-consumer contracts. (See Chapter 14 for a discussion of which States have abolished this concept and for specific conditions covering such agreements.)

A franchise agreement

Franchisee agrees to sell franchisor's product or service

A 'franchise agreement' is a special type of contract. It is made between two parties: the **franchisee** and the **franchisor**. It is an agreement made between a supplier of a product or service, or an owner of a trade mark or copyright (franchisor) and a reseller (franchisee). The basis of the agreement is that the franchisee agrees to sell the franchisor's product or service, or agrees to do business under the franchisor's name.

An important part of the franchising agreement is that the franchisor agrees to maintain a continuing interest in the business of the franchisee in areas such as marketing, training, product control, advertising and technical knowledge.

An example of a type of business that is suitable for franchising is a restaurant. A franchise agreement may be designed to protect a system or unique way of operating that business (e.g. a unique recipe). Such a business may become a chain of restaurants offering the same standard of food, quality and service. Pizza Hut is an example.

Advantages

Franchise agreements provide advantages for both the franchisee and the franchisor. Advantages for the franchisor include the ability to penetrate markets quickly, access to capital resources of the franchisee and risk sharing. The franchisee receives the advantage of an instant reputation because the franchisor's product is established in the market. The franchisee can also benefit from marketing arranged by the franchisor and from the financial expertise of the franchisor. The risk of failure is generally reduced because the franchisee is buying into an established business.

It is possible to classify a franchise agreement into one of three main categories set out in Table 9.6.

TABLE 9.6 Three categories of franchise agreements

Category	Description
Product franchise	■ The franchisee acts as a distributor of a particular product. An example is a service station (e.g. BP or Mobil)
System franchise	■ A franchisor has developed a unique or individual manner of doing business and the franchisee can use that system (e.g. fast food outlets)
Processing or manufacturing franchise	■ The franchisor provides an essential ingredient or know-how to a processor or manufacturer (e.g. in the softdrink industry where the franchisor provides the syrup that is the basis for the softdrink)

WRITTEN FRANCHISE AGREEMENT

A written agreement will be drawn up between the franchisor and franchisee and will outline the legal obligations of each party. The parties to a franchise agreement must comply with the provisions of the Franchising Code of Conduct, the provisions of which will now be discussed.

THE FRANCHISING CODE OF CONDUCT

Application of Code

On 1 July 1998 the Franchising Code of Conduct came into operation. It applies to all new franchises and to the renewal, extension or transfer of existing franchises on or after 1 October 1998. The Code has the force of law and is set out in the Schedule attached to the *Trade Practices Act* (Industry Codes—Franchising) Regulations 1998. The Code is prescribed and is declared a mandatory industry code under s. 51AE of the *Trade Practices Act 1974*.

The key sections of the *Trade Practices Act 1974* that apply to franchises are s. 51AC and s. 51AD.

The aim of the Code

Professor Allan Fels, the Chairman of the Australian Competition and Consumer Commission (ACCC), in a speech he gave in Melbourne on 1 September 1998 titled 'Administering the Franchising Code of Conduct', described the aim of the Code as follows:

> This Code was introduced to address serious market failure problems, particularly in terms of information failure and the transaction costs associated with franchisees gaining information or obtaining affordable redress when things went wrong in the course of the franchise agreement. There have been some well-known cases where franchisees have lost their shirts as a result of the acts of unscrupulous franchisors. Apart from being a disaster for the franchisees in question, it reflects poorly on the franchising sector as a good place in which to invest.

Prior to the Code being introduced, there was a voluntary system of control. The fact that schemes are voluntary makes an effective control regime difficult. Those who need to comply are usually those who do not comply if control is voluntary.

Specific provisions of the Franchising Code of Conduct

Rights and obligations

The Code imposes obligations on franchisors and establishes rights for franchisees.

Disclosure requirements

A **franchisor** or a person transferring a franchise is required to give a **disclosure document** to the prospective **franchisee** within fourteen days of entering into the agreement, or before payment of non-refundable money in respect of the agreement. This document must contain the details set out in Table 9.7.

TABLE 9.7 Matters requiring disclosure

Topic	Details required
Identity	■ Particulars of the franchisor and any other persons who have management responsibilities for the franchisor's business
Experience	■ A summary must be provided of the business experience of the franchisor and any associated management personnel in the last ten years
Litigation	■ Details are required of any current legal proceedings against the franchisor; any bankruptcy, insolvency or criminal convictions in the last ten years; and any civil proceedings in the last five years
Payments to agents	■ Details must be given of any payments made by the franchisor in connection with the introduction or recruitment of the franchisee
Existing franchises	■ Details are required of existing franchises held by the franchisor and the number of franchises that have been transferred, terminated or bought back by the franchisor in the last three years
Intellectual property	■ Details are required of every patent, copyright, design and trade mark that is material to the franchise system. There must be a description of the intellectual property and what the franchisee's rights and obligations are in connection with the use of this property. If the intellectual property is owned by another person, details must be given of the rights to use it
Franchise territory	■ The franchise territory must be defined. It may be for either an **exclusive** or **non-exclusive** territory or it may be limited to a particular site. There should be a statement as to whether it is permissible for the franchisor to operate a business substantially the same as the franchise in the territory and whether the franchisor can change the territory
Supply of goods and services to franchisee	■ Any restrictions preventing the franchisee from acquiring goods from other sources must be stated. If the franchisor is required to maintain a franchisee inventory level, this must be stated
Sites	■ There must be a statement of the policy of the franchisor in the selection of a site for the franchise. If another franchise used the same site and ceased to operate, then details must be given as to why this was the case
Payments	■ Details must be given of any payments that are required prior to entering the agreement
Marketing and other co-operative funds	■ If membership of any fund is required, details and the amount of financial contribution required must be given

Financing	■ If the franchisor is offering the franchisee a financing arrangement, then all details of the same must be provided
Franchisee's and franchisor's obligations	■ A summary must be provided of the franchisee's and franchisor's obligations under the agreement, and a summary of the conditions of the franchise agreement and obligations to sign related agreements such as the lease of premises
Earning information	■ If earning information for the franchise is given, it must be based on reasonable grounds
Financial details	■ The franchisor must provide a statement of solvency and a copy of the profit and loss statement and the balance sheet

The ACCC produces the *Franchising Code of Conduct Compliance Manual*, which assists franchisors and franchisees in complying with the Code. This contains a pro-forma disclosure document that may be used by parties to a franchise agreement.

Cooling-off period

The Code gives a franchisee the right to terminate a franchise agreement or an agreement to enter into a franchise agreement:

- within seven days of entering the agreement, or
- within seven days of paying money under the agreement—whichever occurred first.

If an agreement is terminated during the cooling-off period, then the franchisor must refund all money paid by the franchisee within fourteen days.

Refund to franchisee

The provisions regarding cooling-off do not apply to the renewal, extension or transfer of an existing franchise.

Copy of lease

It is quite common for a franchisee to lease premises to operate the franchise business either from the franchisor or an associate of the franchisor. If this is the case they must be supplied with a copy of the lease.

Association of franchisees

It is unlawful for a franchisor to prevent a franchisee from forming an association or associating with other franchisees (provided their purpose is lawful).

Prohibition of general release from liability

The Code prohibits a franchise agreement from containing or requiring the franchisee to sign a general release of the franchisor from liability towards the franchisee.

Transfer of the franchise

Franchisor cannot unreasonably withhold consent to transfer of franchise

The Code prohibits the franchisor from unreasonably withholding consent to the transfer of the franchise. The Code lists the circumstances in which it would be reasonable to withhold consent. These are set out in Figure 9.10.

- The proposed transferee is unlikely to be able to meet financial obligations under the franchise agreement
- The proposed transferee has not met the selection criteria of the franchisor
- The existing franchisee has not made reasonable provision to pay an amount owing to the franchisor
- The franchisee has failed to correct a breach of the franchise agreement

FIGURE 9.10 When consent can be withheld

Termination of a franchise

Methods of termination

The Code provides for termination of a franchise agreement in the following situations:

- by the franchisor where there is a breach by the franchisee
- by the franchisor where there is no breach by the franchisee
- in special circumstances.

We will consider each of these methods of termination.

Termination by the franchisor where there is a breach by the franchisee

If the franchisee breaches the franchise agreement it is open to the franchisor to terminate the agreement. Reasonable notice of intention to terminate the agreement must be given by the franchisor to the franchisee and the franchisee must be given a reasonable time to remedy the breach of the agreement.

Termination by the franchisor where there is no breach by the franchisee

A franchisor can terminate if there has been no breach by the franchisee if the agreement provides so. However, the franchisor must give the franchisee reasonable notice of the proposed termination and the reasons for it.

Termination in special circumstances

The agreement can be terminated by the franchisor without giving the franchisee reasonable notice if the franchisee:

- voluntarily abandons the franchise
- becomes bankrupt or insolvent under administration
- is convicted of a serious offence
- no longer holds any licence necessary to conduct the franchise business
- operates the franchise in a way that endangers public health and safety
- operates the franchise business fraudulently
- agrees to the termination.

Resolution of disputes

Complaint-handling procedure

The Code requires that a franchise agreement entered after 1 October 1998 provide a complaint-handling procedure for the resolution of disputes between the franchisor and the franchisee. The Code requires the **complainant** (the person making the complaint) to inform the **respondent** (the person with whom the complainant has the dispute) in writing of:

- the nature of the dispute
- the outcome desired by the complainant
- the action the complainant thinks will settle the matter.

Mediation of dispute

If the parties are unable to resolve the dispute themselves, either party can refer the dispute to **mediation**. An independent third person (**mediator**) will try and assist the parties to resolve the dispute. Unless there is an agreement to the contrary, the parties will bear the costs of the mediation hearing equally.

It is also possible for parties to commence legal proceedings under the franchise agreement. The Code encourages alternate dispute resolution as the first option.

LAW IN ACTION

The ACCC was made aware of unconscionable conduct in relation to a franchise. A franchisor required its franchisee to accept all goods supplied by the franchisor unless the franchisee returned them within forty-eight hours of receipt. If the goods arrived on a Friday afternoon the franchisee was unable to return the goods within the required period and was liable to pay for the goods. This was the case regardless of whether the franchisee was overstocked or the goods were inappropriate for that store. In this case it was the latter—heavy overcoats for a retail franchise in Townsville, Queensland.

Lawyer warns franchise parties

Victoria
By D. M. WALKER

Franchisors must avoid pressuring people to purchase franchises and insist they obtain professional advice before entering a franchise, a contract lawyer said last week.

Mr Phil Colman, a partner at the legal firm Mason Sier Turnbull, said the new unconscionable conduct provisions in the *Trade Practices Act* should be a warning for franchisees and franchisors alike.

Franchisors should also inform franchisees they were free to pull out of the franchise negotiations during the negotiating phase.

"The unconscionable conduct provisions will result in fairer business transactions and you won't have the situation where large companies are going to be able to exert unfair pressure on small organisations," he said.

Mr Turnbull said franchisors should also review contracts to ensure there were no conditions which a court could say were not necessary for their company's legitimate business interests.

He said "legitimate business interests" would vary, but companies should consult lawyers on where the contract's other party could claim unconscionable conduct because of such superfluous conditions.

A judge could also consider if a franchisor had been consistent with all their franchisees, but if companies had a legitimate reason to treat different parties differently, Mr Turnbull said inconsistency might not be a problem.

Unconscionable conduct relates to negotiations where one party is particularly disadvantaged in dealing with a stronger party.

The disadvantage could be poverty, sickness, age, drunkenness, illiteracy or lack of education, or insufficient explanation of the dealings.

Parties found guilty of unconscionable conduct may have to pay compensatory damages, have injunctions issued against them, or have contracts voided or altered.

The recent amendments to the *Trade Practices Act* on unconscionable conduct also make corporations comply with appropriate industry codes.

In assessing unconscionable conduct in the case of franchisor–franchisee relationships, courts would consider:

- retail strengths of both parties' bargaining positions in contract negotiations.
- if the franchisee had to comply with conditions which were not reasonably necessary to protect the legitimate interests of the franchisor.
- if the franchisee could understand all relevant documents.
- if the franchisee was unduly pressured to sign or agree to the contract.
- if one party could acquire goods and services acquired from the other party from other people.
- if the franchisor acted in the same way to all franchisees.
- how much the franchisor told the franchisee about their plans and how they would affect the franchisee.
- how much the franchisor was willing to negotiate terms and conditions of any contract for supplying goods and services with the franchisee.

Source: The *Age*, 3 August 1998, p. 5, Business Section

Newspaper discussion questions

1. Identify the significance of the unconscionable conduct provisions to franchise agreements discussed in the article.
2. Explain how unconscionable conduct may arise in the context of a franchise agreement.
3. What are the potential penalties for a party found guilty of unconscionable conduct?
4. Summarise the relevant considerations for the court in assessing whether unconscionable conduct exists.

OTHER STATUTORY PROTECTION OF FRANCHISEES

Petroleum Retail Marketing Franchise Act 1980 (Cwlth)

There is statutory regulation of franchises between oil companies and service stations in the *Petroleum Retail Marketing Franchise Act 1980*.

Franchise agreements and Part IV of the *Trade Practices Act*

Potential for conflict

Is there a conflict between franchise agreements and Part IV of the Act? Part IV outlaws restrictive trade practices, which are practices that reduce competition. A franchise agreement, by its nature, will impose restrictions on the way a business is operated. For example, an agreement may provide that a franchisee may only take supplies from the franchisor.

As a general rule, at common law, franchise agreements are not regarded as being in restraint of trade. The reason for this is that a franchise agreement is seen as a voluntary restriction of liberty on the part of the franchisee. It would be necessary, however, to consider specific examples of prohibited restrictive conduct and apply them to a franchise agreement.

Exclusionary provisions

Reducing competition

Section 45 of the *Trade Practices Act* prohibits corporations from making or giving effect to contracts, agreements or understandings that contain an exclusionary provision. Such a provision would apply to contracts made by parties that were in competition and would have the effect of reducing competition. It is arguable that such a prohibition would not apply to a franchise agreement because, although such an agreement may contain exclusionary provisions, the parties (franchisee and franchisor) are not in competition with one another.

Exclusionary dealing

This is prohibited by s. 47 of the *Trade Practices Act*. Exclusionary dealing arises where a corporation supplies, or refuses to supply, goods or services at a particular price, or allows a discount or credit on the condition that the person dealing will acquire the goods or services of a particular kind from a particular person. Potentially, a franchise agreement may fall foul of this prohibition if the franchisor insists that the franchisee acquire certain goods only from a specific supplier named by the franchisor.

Resale price maintenance

Uniform pricing

Section 48 of the *Trade Practices Act* prohibits resale price maintenance. This occurs when goods are supplied and the supplier stipulates the price at which they can be resold. Certainly franchise chains impose uniform prices and in many cases it is the franchisor who dictates the resale price of goods sold by the franchisee. On the face of it, this is resale price maintenance and is prohibited by the *Trade Practices Act*.

Monopolies

Substantial control of market

Section 46 of the *Trade Practices Act* prohibits abuse of monopoly power by corporations that are in a position to substantially control a market for goods and services. Such a company is prohibited from taking advantage of its market power for the purpose of eliminating or damaging a competitor. Very large franchises that have a substantial share of market power may fall foul of this prohibition.

Misleading and deceptive conduct

Section 52 of the *Trade Practices Act* prohibits misleading or deceptive conduct. A franchisor or a franchisee could be liable for misleading and/or deceptive conduct.

Unconscionable conduct

Section 51AA prohibits unconscionable conduct (both ss. 52 and 51AA are discussed in some detail in Chapter 13). Again, the parties to a franchise agreement may be liable for unconscionable conduct.

Check your progress 9.3

Place a tick in the appropriate box.

1. The failure of an event to take place may lead to a contract being discharged due to the:

(a) doctrine of mutual discharge ☐

(b) doctrine of frustration of contract ☐

(c) doctrine of privity of contract ☐

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2. A breach of contract that takes place before performance of some or all of a party's contractual obligations is called:
(a) an anticipatory breach ☐
(b) an actual breach ☐
(c) a fundamental breach ☐

3. If one party has fulfilled part of their contractual obligations and the other party breaches the contract, an appropriate remedy could be:
(a) rescission of the contract ☐
(b) an injunction ☐
(c) quantum meruit ☐

4. An order for specific performance will:
(a) prevent a party to a contract from performing a particular act ☐
(b) result in liquidated damages being paid to the wronged party ☐
(c) require that a party perform their obligations under the contract ☐

5. The Franchising Code of Conduct in the *Trade Practices Act* is a mandatory code.
(a) true ☐
(b) false ☐

6. The Franchising Code of Conduct:
(a) imposes obligations on franchisors and establishes rights for franchisees ☐
(b) establishes rights for franchisors and imposes obligations on franchisees ☐
(c) requires the franchisee to provide the franchisor with a disclosure document ☐

7. The Franchising Code of Conduct provides the franchisee with a cooling-off period of:
(a) 4 days ☐
(b) 6 days ☐
(c) 7 days ☐

Chapter overview

The main points made in this chapter are:

1. The contents of a contract can be called 'terms'.

2. Contractual terms can be express or implied. Whether a statement has become a term of a contract can be determined by considering the time it was made, its form, the intention of the parties and whether one party has special skill or expertise that was relied on by the other party.

3. Express terms, whether expressed in writing or verbally, can be classified as either 'conditions' or 'warranties'.

4. A 'condition' is a fundamental or vital term of a contract. A 'warranty' is a term of less importance.

5. A 'condition precedent' is a condition that must be met before an enforceable contract is created. A 'condition subsequent' is a condition stated in the contract that, if met, will discharge the contract.

6. Terms of a contract can be implied, either by the courts, by statute, or by custom or trade usage.

7. The courts are only willing to imply terms into a contract to give it business efficacy. An implied term must be capable of being clearly expressed, and it must be imperative that the term exists for the successful carrying out of the contract.

8. Terms can be implied into a contract when custom or usage demands. Terms will only be implied if they are reasonable, notorious and not inconsistent with any other term of the contract or with a statute
9. An exclusionary or exemption clause seeks to limit the liability of one party to a contract.
10. Exemption or exclusionary clauses can only be relied on to avoid liability if they have become terms of a contract. This will only be so if the other party is given reasonable notice of same, before or at the time the contract is made.
11. The doctrine of privity of contract provides that only parties to a contract can enforce the terms of the contract. Only parties to a contract can sue or be sued on the contract.
12. There are exceptions to the doctrine of privity of contract. They include contracts of insurance, the law of agency and where a person acts as trustee for another.
13. A contract can be discharged in several ways: by performance, agreement between the parties, operation of law, frustration and breach of contract.
14. A contract can be discharged by performance—either actual or attempted performance (tender).
15. The parties to a contract can agree to discharge it. Where both parties still have obligations to perform pursuant to the contract, the term 'mutual discharge' is used.
16. Parties to a contract can discharge it by substituting a new contract for the old one. This can be done by novation of contract whereby one party is replaced by another to fulfil contractual obligations.
17. Accord and satisfaction is another method of discharging a contract. This occurs where a party who has completed their obligations pursuant to a contract agrees to relieve the other party of their obligations in return for the other party doing something different.
18. A contract itself may contain a provision for discharge. This may be in the form of an option to terminate or a condition subsequent.
19. Operation of law will discharge a contract in the following circumstances: bankruptcy of a party to the contract, material alteration of a written contract, and merger.
20. Frustration of contract occurs when an unexpected event so changes the nature of the contract that, to give regard to the intentions of the parties, a new contract would need to be created.
21. 'Frustration of contract' is the impossibility to perform a contract. The frustrating event must be unforeseeable and the fault of neither party to the contract.
22. Events that will frustrate a contract include destruction of subject matter, failure of a specific event to take place, illness or death, a change in the law, or government interference in a contract.
23. The effect of frustration is to end the contract—to discharge it. At common law, money payable pursuant to a frustrated contract will be recoverable if there has been a total failure of consideration.
24. If an event increases the burden of performance placed on one party to a contract, then the contract may be discharged on the basis of frustration.
25. There are several statutes that modify the common law rules regarding frustration of contract. These statutes allow recovery of money paid, although there may not be a total failure of consideration. The statutes also provide a means of recovery for a party that has incurred expense pursuant to a frustrated contract.
26. A 'breach of contract' is a failure by a party to comply with the terms of a contract. A breach can be actual or anticipatory, total or partial.
27. An anticipatory breach occurs before performance occurs or is completed. It will entitle the injured party to treat the contract as discharged.
28. A breach of a term of a contract may bring the contract to an end. This depends on whether the term breached is a condition or a warranty.

29. A breach of a condition entitles the injured party to rescind the contract and claim damages. A breach of a warranty gives no right of rescission, only a right to sue for damages.

30. A claim for *quantum meruit* is a claim by a person who has performed part of a contract to recover an amount that reflects the work they have performed. This is so, despite the breach of the contract by the other party.

31. Remedies available for a breach of contract include rescission of contract, damages, an injunction, an order for specific performance and *quantum meriut*.

32. 'Damages' are a monetary amount paid to a person who has suffered loss because of a breach of contract. Damages aim to compensate and can only be claimed in respect of losses that are foreseeable. The loss can be financial or non-financial. The loss may be present or future.

33. The amount of damages awarded for a breach of contract is the difference between the contract price and the market price. There is also the right to sue for consequential losses that flow from a breach of contract.

34. A person is under a duty to mitigate their loss.

35. Damages can be liquidated or unliquidated.

36. 'Specific performance' is an equitable remedy ordering a party to specifically perform contractual obligations. It is usually restricted to contracts for the sale of land and contracts for the purchase of rare items.

37. An 'injunction' is an equitable remedy where a court orders a person to refrain from doing or continuing to do a particular act.

38. Injunctions and orders for specific performance will only be awarded where damages are an inadequate remedy.

39. Speciality contracts that are common in the business world include leases, hire purchase agreements and franchise agreements.

40. A 'franchise agreement' is an agreement made between the supplier of a product or service, or an owner of a trade mark or copyright, and a reseller. The franchisee agrees to sell the franchisor's product or service or to do business under the franchisor's name.

41. Franchise agreements can be divided into three main categories: product franchises, system franchises and processing or manufacturing franchises.

42. The parties to a franchise agreement must comply with the provisions of the Franchising Code of Conduct.

43. The Code imposes obligations on franchisors and establishes rights for franchisees.

Consolidation questions

1. Why is it important to establish that a statement has become a term of a contract?

2. Distinguish between a condition and a warranty.

3. Explain and provide an example of a condition precedent.

4. Identify the terms that may be implied in contracts by courts, by statute and by custom or trade usage.

5. Explain the doctrine of privity of contract.

6. Outline the circumstances that will result in the discharge of a contract.

7. What is the aim of a payment of damages for a breach of contract?

8. Provide an example of conduct that may lead to the frustration of a contract.

9. What is a 'speciality contract'?

10. Define a franchise agreement and explain the aim of the Franchising Code of Conduct.

11. Explain the circumstances under which a franchise agreement can be terminated.

12. Outline the specific requirements imposed on parties who entered in to franchise agreements after 1 October 1998 with respect to the resolution of disputes.

Case study questions

1. Linien buys a backpack from Kathmandu Adventures Ltd. Delivery of the backpack is to be made on 1 May 2002, the day before Linien is due to leave on her overseas holiday. Kathmandu Adventures Ltd fails to deliver the backpack on the agreed date and says it will take a further week. What rights does Linien have against Kathmandu Adventures Ltd? Answer this question without reference to rights that may exist under the *Trade Practices Act 1974* (Cwlth) or the State fair trading Acts.

2. Simon and Angela sign a contract for the purchase of a house and make the contract subject to the condition that they will sell their existing house, within a period of four weeks, at a price not less than $250 000. What type of condition is this? Give reasons for your answer.

3. Aldo agrees to sell his sports store to Lucy. Settlement is to take place on 20 September 2002. At midnight on 17 September 2002, the shop is destroyed by a fire caused by an electrical fault. Would Lucy have any action against Aldo for breach of contract?

4. Ian enters into a contract to write a column to be published on a weekly basis in a national magazine. After three weeks of publishing his column, the magazine decides to abandon the column. What right does Ian have against the magazine?

5. Susan makes a contract to purchase an original sculpture from Kent, a well-known artist, for $100 000. Subsequently Kent refuses to part with the sculpture. Would damages be an appropriate remedy for Susan? What alternative remedies might be more appropriate from Susan's point of view?

6. Donzi Marine agrees to supply Kakadu Tours with three specially fitted boats suitable for extended inland fishing and adventure water sports. Donzi Marine agrees to supply the completed boats by 30 June 2002 in time for three fully-booked holiday tours. The boats did not arrive until 28 July 2002. The delay caused Kakadu Tours to lose half of its clients through cancellations, the remaining clients agreeing to re-book at another time. The delay cost Kakadu Tours $20 000. Discuss the possible remedies Kakadu Tours may have against Donzi Marine.

7. Cesare purchases a franchise to operate a business that teaches classical guitar to students at a number of private secondary schools. The franchisor, Guitar Classical Pty Ltd, presents Cesare with financial documents that indicate that an annual income of $40 000 should be earned by Cesare within one year. Advise Cesare on what information should be included in the franchise agreement and how his interests can be effectively protected.