

Contracts

TABLE OF CONTENTS

1. Introduction to Contract Law	c. Consideration	6. Remedies for Breach
2. Formation of a Contract	d. Legality	a. Damages
a. Intention to Create a Legally Binding Relationship	3. Interpreting Contracts	b. Specific Performance
b. Offer and Acceptance	4. Contractual Terms	c. Injunctions
	5. Breach of Contract	7. Unenforceable Contracts

1. Introduction to Contract Law

A contract is an agreement which is made between two or more parties that is enforceable by law and therefore becomes a binding contract.

Buying groceries, renting a car, riding the subway, and renting an apartment are all contracts, as these interactions are based on an agreement where one party agrees to pay money for a good or service in exchange for the other party providing the good or service.

These common contracts can be oral or written. They can be explicit, such as a rental agreement which states in detail the terms of the agreement, or implicit, wherein you purchase a frozen yogourt, serve yourself, and then pay for it at the cash register.

Not all agreements are recognized by law as a contract. For example, if you agree to meet a friend for lunch and the friend does not show up, there is an agreement, but the law would not recognize it as an enforceable contract.

In order for an agreement to be an enforceable contract, four essential elements must be present:

1. an intention to create a legally binding relationship;
2. offer and acceptance;
3. consideration; and
4. legality.

Contracts are based on the expectation that parties will live up to the promises made in the contract. If a party does not fulfill its promise, then it has breached the contract. The breach may result in financial consequences in the form of damages to the defaulting party.

2. Formation of a Contract

There are four essential elements of a contract as discussed in section 1. We will discuss these in detail in this section.

a. Intention to Create a Legally Binding Relationship

The law presumes that parties entering into an agreement intend for the agreement to be binding. This means that the parties intend for the promises to be fulfilled, otherwise they may sue

and be sued for breaking the promises made in the agreement.

Agreements made between unrelated parties, meaning non-family members and parties not related by business interests (arm's-length transactions) are presumed to be binding, unless the presumption is rebutted (i.e., proved otherwise): Laurence M Olivo & Jean Fitzgerald, *Fundamentals of Contract Law*, 3rd ed (Toronto: Emond, 2012) 13.

Agreements made between family members and friends are considered non-arm's-length transactions and are not presumed to be binding. The onus would be on the party wishing to enforce such a contract to show that the parties intended for the contract to be binding.

In the case of *Jones v Padavatton*, [1969] 2 All ER 616 (CA), a mother and daughter agreed that the mother would pay an allowance to the daughter if the daughter moved to England to study for the Bar. The parties later had a dispute, and the mother wanted to evict the daughter from a house that the mother had purchased and in which the daughter lived. The court used the reasonable person test and Lord Justice Salmon observed that the daughter was an adult and had a good job. When she accepted the mother's offer, the daughter was giving up her current life situation and doing something that was going to please her mother. The daughter was induced by her mother's promise to pay her an allowance while she was studying. A reasonable person would think that there was a serious intention on behalf of both parties to form a binding agreement.

If a party wishes to rebut the presumption that the contract is binding, the onus (i.e., the responsibility of proof) falls on that party to prove that he or she did not intend to enter into a binding contract. The test to determine whether the party had the intention is, "Would a reasonable person hearing the promise assume that the promisor intended to be bound?": Olivo & Fitzgerald at 12.

b. Offer and Acceptance

When both parties agree to the same thing, it is called a meeting of the minds, and must be present in a valid contract. A meeting of the minds occurs where there is an offer and unconditional acceptance by the parties to the contract. For example, John makes an offer to sell 100 rugs to Harry in exchange for a payment by Harry of \$10,000. Harry unconditionally accepts John's offer by way of a written or verbal agreement.

Disputes arise in the absence of a meeting of the minds. This usually happens when the parties interpret the terms of the contract in different ways. For example, one party may believe that the offer is open to further negotiations and the other party believes the offer is final. In order for a court to determine if there was a meeting of the minds, two questions must be answered:

1. Did the offer expire when it was accepted?

Offers may expire in the following ways:

- **lapse**—expiration of an offer occurs when there is a clear date of expiry; after this date, the offer cannot be accepted;
- **revocation**—party making the offer can take back the offer any time before it is accepted;
- **option agreement**—exception to the revocation rule, where one party gives money or something of value to keep the offer open for a specified period of time; or
- **counteroffer**—party accepts an offer but changes certain terms in the offer.

2. Was the acceptance of the offer properly communicated?

Courts look at the following to determine acceptance:

- offeree (the party to whom the offer is made) communicates acceptance of the offer to offeror (the party that makes the offer), specifically in the manner stated in the offer (e.g., acceptance to be sent by fax);
- acceptance may be communicated by action alone (e.g., Jane orders stationary from Bill, who sends her the order without verbal communication; sending the order is acceptance);
- mailing the acceptance is effective on the date it was put in the mail; or
- electronic acceptance is effective when it is in the inbox of the offeror and can be retrieved; it is irrelevant if the acceptance was actually retrieved: *Electronic Commerce Act, 2000*, SO 2000, c 17.

c. Consideration

Payment, or something of value, is given by a party in exchange for the other party keeping a promise (e.g., payment of money for the promise to deliver oranges).

Promising to do something for free (that is, a gratuitous promise) is not a binding contract (e.g., a parent promises to buy his or her child a car).

Exceptions to the requirement of consideration:

1. settling for a lower payment to satisfy a debt;
2. contracts made under seal; and

3. promissory estoppel (e.g., a party relying on another party's promise to pay an increase in the price of goods without a new agreement can rely on this doctrine to enforce the promise to pay, if the party relied on it in good faith and to its detriment).

d. Legality

Contracts must be for a legal purpose (i.e., a contract to commit a crime is not enforceable).

3. Interpreting Contracts

Courts help resolve disputes when contracts are poorly drafted. They use the rules of construction in order to interpret such contracts. The rules of construction consist of the following:

1. **objective test**—if the term is vague, the court will ask, “What would a reasonable person understand the vague term(s) to mean?”;
2. **interpreting the contract against the drafter**—preferring the interpretation offered by the party who did not draft the contract;
3. **determining the parties' intentions**—enforcing the contract based on the intention of the parties; and
4. **the parole evidence rule**—if the language of a written contract is clear, the court will not look to any other evidence, such as verbal statements made during negotiations, to interpret or alter its terms.

4. Contractual Terms

Below is a non-exhaustive list of terms often found in a contract:

- **liquidated damages**—payment of money if a breach occurs;
- **cancellation**—consequences if one of the parties decides to terminate the contract;
- **condition precedent**—a specific thing or specific things must happen or be done before a party will have to perform its obligations;
- **condition subsequent**—occurrence of a specified event that terminates the contract;
- **disclaimer**—limits amount and types of damages that a party may have to pay in the event a disclaimer was not included in the contract (e.g., courier company will not be liable for more than \$30 in the event a package is lost);
- **exclusion**—excludes certain services that are not covered in the contract (e.g., extended warranty may exclude repairs resulting from damages);
- **governing law**—the law which will be used to enforce and/or interpret the contract (e.g., the contract will be construed and enforced by the laws of the province of Ontario);
- **indemnity**—requires party A to reimburse party B for losses, expenses, or damages that party B may incur by being sued by others for the actions of party A (e.g., a landlord wants to be indemnified by the tenant if the tenant's customers sue the landlord for any reason);
- **missing terms**—if parties do not express their intentions properly within the written contract, the courts may, under limited circumstances, imply terms; this is done when the court believes that the term is necessary to give effect to the parties' intentions (test: a party who wants a term to be included must show that the term reflects the intention of the parties and the term is

reasonable, clear, and does not contradict an express written term in the contract);

- **entire agreement**—parole evidence rule, where parties cannot rely on statements that are made verbally and not in the written contract;
- **force majeure**—unpredictable event (e.g., war or natural disaster) out of the parties' control that makes fulfillment of the contract impossible; and
- **arbitration**—if parties agree to resolve all disputes arising under the contract by arbitration, they cannot litigate the dispute unless all parties agree to amend this term.

5. Breach of Contract

When a party or parties do not perform their obligations in the contract, this is a breach of contract. There are several types of breaches:

1. **breach of condition**—if a party does not perform an important term of the contract, the innocent party may treat the contract as an end and claim for losses or damages;
2. **breach of warranty**—non-performance of a less important term requires the innocent party to perform the contract and to claim for losses and damages; and
3. **vicarious liability and performance**—employer is responsible for employees who do not perform a contractual obligation of the employer.

As it is difficult at times to determine whether a term is a condition or a warranty, it is advisable to clearly identify the applicable term as a condition or warranty.

6. Remedies for Breach

a. Damages

The innocent party is usually entitled to monetary compensation for a breach. If the contract is silent about quantifying damages, then the courts will apply the *Hadley v Baxendale*, [1854] EWHC Exch J70, test:

The innocent party should be compensated in the amount that would have been reasonably foreseeable by the parties and which would put the innocent party in a position they would have been in had the breach not occurred.

An award of damages is subject to the following considerations:

- **duty to mitigate damages**—innocent party must take reasonable steps to reduce damages resulting from the breach;
- **remote damages**—damages suffered by the innocent party must be reasonably foreseeable; and
- **punitive damages**—punishing the breaching party for reprehensible conduct.

b. Specific Performance

A court orders a party to perform its obligations under the contract. Applicable to contracts that deal with very unique subject matters (e.g., sale of one-of-a-kind antiques).

c. Injunctions

A court orders a party to stop doing a specific action (e.g., stop the seller of a business from opening the same business next door to the one he or she just sold).

ELEMENTS OF A BINDING CONTRACT

1. INTENTION

Party A Party B



Intention to enter a binding contract

Rebuttable presumption

2. OFFER AND ACCEPTANCE

Party A makes offer to Party B

Party B accepts offer unconditionally

=

Meeting of the minds

3. CONSIDERATION

Party A → Party B

pays or gives something of value

Party B → Party A

promises to do something

Promise to do something for free = not binding

4. LEGALITY

Purpose of contract must be legal

7. Unenforceable Contracts

These occur when a party has been misled or forced to enter into a contract. Circumstances when a contract may be unenforceable include:

1. **misrepresentation of material fact**—party makes a false statement of fact which is relied upon by the innocent party to enter the contract; the innocent party does not have to prove that the statement was made intentionally; remedies will depend on whether it was negligent, fraudulent, or innocent misrepresentation (e.g., the remedy for innocent misrepresentation of material fact is rescission, which is treating the contract as though it never existed);
2. **mistake**—party takes advantage of a serious mistake in the contract (e.g., interest rate in the contract is mistakenly identified as 20 percent when it was supposed to be 10 percent, and the lender charges the higher amount without telling the debtor);
3. **duress**—party enters the contract by being threatened with physical or serious economic harm;
4. **undue influence**—party is pressured to enter into a contract by being prevented from exercising its free will (e.g., employer

telling an employee that he or she must accept the employment contract without having time to review it).

There is a presumption of undue influence in certain relationships, such as lawyer/client and doctor/patient, and it does not have to be proven by the party making this assertion.

Where there is an imbalance of power, the party in a position of more power should encourage the other party to obtain independent legal advice;

5. **unconscionable agreement**—unreasonably one-sided contract; the test is whether there is a gross inequality of bargaining power or the benefit to the “weaker” party is grossly inadequate;
6. **minors**—a person under the age of majority (18 years in Ontario) may not be bound by the terms of the contract; the

parents cannot be held responsible unless they are parties to the contract or are guarantors (i.e., a person who promises to pay if the main party to the contract defaults on payment); and

7. **capacity**—if a party was suffering from a mental condition or impaired by drugs or alcohol, such that they did not know what they were doing when entering the contract, the party must prove that:

- a. they were incapacitated when they entered the contract; and
- b. that the other party knew of their condition at the time.