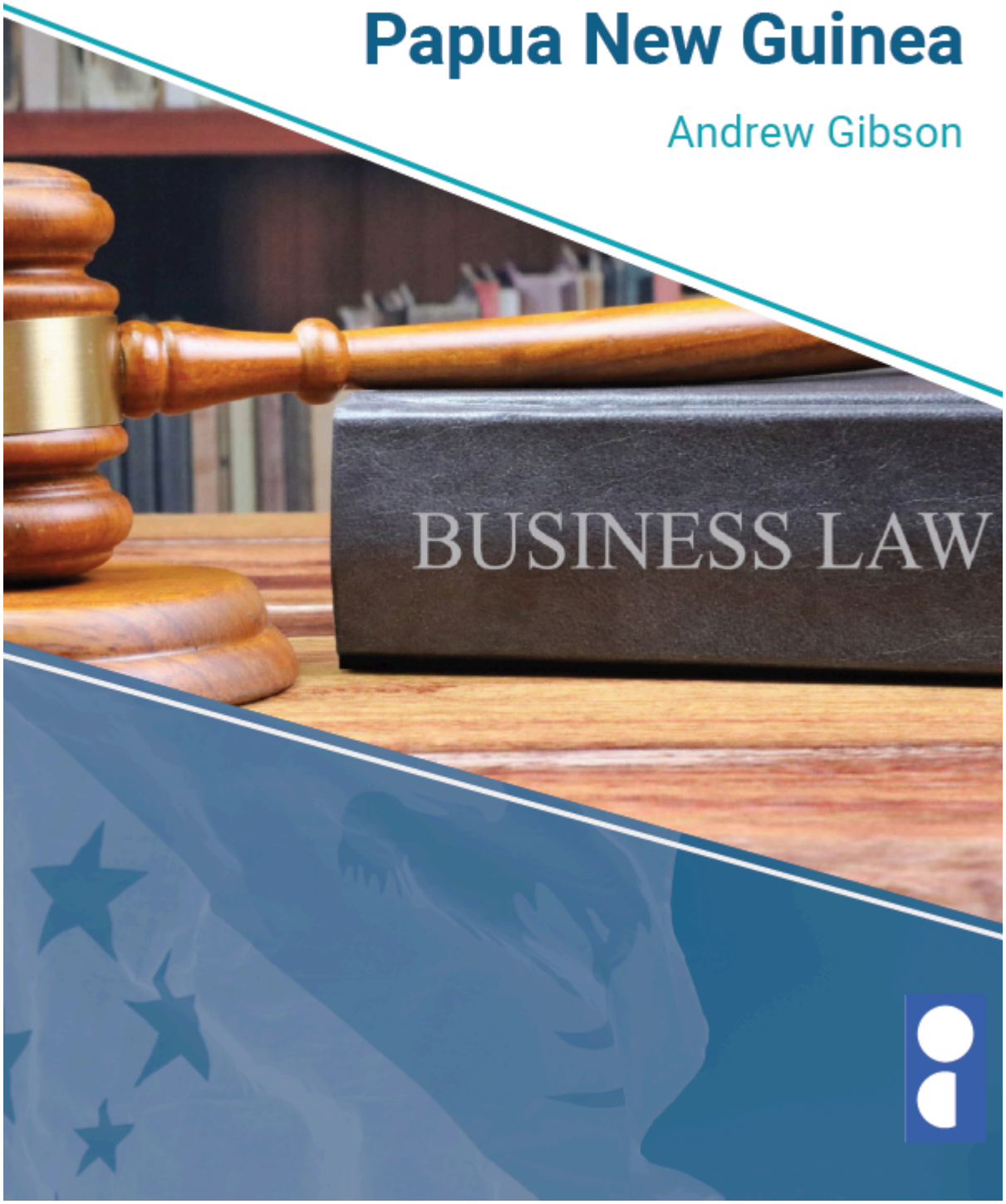
Southern Cross University

Introduction to Business Law in Papua New Guinea

Andrew Gibson



Introduction to business law in Papua New Guinea

INTRODUCTION TO BUSINESS LAW IN PAPUA NEW GUINEA

ANDREW GIBSON

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Lismore, New South Wales

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With over 40 years of lecturing and practitioner experience at RMIT, Griffith University and currently Southern Cross University where he is an Adjunct Associate Professor in the law discipline, Andy specialises in commercial, sports and torts law for undergraduate and postgraduate students, as well as government and private sector clients.

Andy spent a number of years at Mallesons Stephen Jaques (now King & Wood Mallesons) in both their Sydney and Melbourne offices as Foundation Director of Legal Education, as well as in private practice.

Andy has written a number of commercially published texts on contract, commercial and sports law, as well as writing chapters on employment, industrial relations and sports law for legal commentary and encyclopaedia publications. *Introduction to business law in Papua New Guinea* is Andy's first OER publication.

In his spare time Andy is president of the Australian Hazelnut Growers Association and a director of the Australian Nut Industry Council.

ACKNOWLEDGEMENT OF COUNTRY

The author acknowledges and respects Aboriginal and Torres Strait Islander peoples as the Traditional Custodians of the lands on which this book was created. We value and celebrate the uniqueness of knowledges, cultures, histories and languages that have been created and shared for at least 65,000 years.

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INTRODUCTION

The aim of this book is to give you, the reader, an introduction to the importance of having a basic understanding of Business Law, and the role it plays in both your everyday life and in business. It will not make you a lawyer but importantly it will enable you to recognise legal issues, minimise exposure to risk, and know when to consult a lawyer. To help you, and to make the book as user friendly as possible, the book is written primarily in the first person where you are the plaintiff. And to provide you with more help you will find Business Tips and summaries throughout the text.

Your feedback and suggestions are invaluable to us. If you have any corrections or ideas to share, please email us at library@scu.edu.au, or complete the Feedback form.

ACKNOWLEDGEMENTS

I would like to express my gratitude to the following individuals whose contributions made this textbook possible:

Melissa Jurd, Talli Allen, Kayleen Wardell, Rachel Ritchie, Nikola Kalamir, Durga Prasad, Sharon Sanders, O'Jay Moka, and Chelsea Croawell, whose expertise and dedication helped enhance the content of this textbook.

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I am deeply appreciative to each of their efforts and commitment to open education.

TABLE OF CASES

TABLE OF STATUTES

Papua New Guinea (PNG)

Bills of Exchange Act 1951

Child Welfare Act 1961

Claims By and Against the State Act 1996

Commercial Advertisement (Protection of the Public) Act 1976

Companies Act 1997

Constitution of the Independent State of Papua New Guinea

Copyright and Neighbouring Rights Act 2000

Criminal Code Act 1974

Electronic Transactions Act 2021

Employment Act 1978

Fair Transactions Act 1973

Fairness of Transactions Act 1993

Frauds and Limitations Act 1988

Goods Act 1951

Independent Consumer and Competition Commission Act 2002

Industrial Safety, Health and Welfare (Amendment) Act 2016

Infants Act 1956

Insolvency Act 1951

Interpretation Act 1975

Lukautim Pikinini (Child) Act 2015

Local-Level Governments Administration Act 1997

Marriage Act 1963

Occupational Safety, Health and Welfare Act 1991

Organic Law on Provincial Governments and Local-level Governments 2014

Packaging Act 1974

Packaging Regulation 1975

Personal Property Security Act 2011

Underlying Law Act 2000

Workers Compensation Act 1978

Wrongs (Miscellaneous Provisions) Act 1975

Australia

Competition and Consumer Act 2010 (Cth)

Corporations Act 2001 (Cth)

Frustrated Contracts Act 1978 (Cth)

Personal Property Securities Act 2009 (Cth)

United Kingdom

Restriction of Offensive Weapons Act 1959 (UK)

Road Traffic Act 1960 (UK)

Road Traffic Act 1988 (UK)

PART I

PART 1. INTRODUCTION TO THE LEGAL SYSTEM IN PAPUA NEW GUINEA

1.

ORIENTATION

Learning objectives

On completion of this Chapter, you should be able to:

- Understand why it is useful to study this subject
- Know where to look for a case
- Know how to find an Act
- Know how to read an Act.

Key terms

At the beginning of each chapter, you will find words/terms that you may not have encountered before. If you come across a word as you are reading and you are not sure what it means, check and see if the meaning of the word is in 'Key terms'. The key terms will often be highlighted throughout the chapter for your ease of reference. Below are some examples from Chapter 2:

- **Citation:** a reference where to find a case in a law report or online.
- **Civil law system:** a complete legal system with its origins in Roman law and the Napoleonic Code.
- **Common law:** that part of English law developed from the common custom of the country as administered by the common law courts.
- **Customary law:** the term used to describe the common law rights and interests of tribal people in land according to their laws, traditions and customs.
- **Equity:** fairness or natural justice.

Introduction

Why study Business Law?

Introduction to Business Law introduces you to an area of life that you probably have not thought much about the law and can't see much relevance for you because you are not studying to be a lawyer, yet. But you may change your mind after you have finished this Unit. But despite what you may think, an understanding of what we will cover in this subject/ unit will be both relevant and useful for you in the future. It is not boring (well perhaps a little bit in parts) or scary (there is a lot of reading) and if you do the Readings and look at what goes on around you, you will realise that it is all very relevant.

It is important to understand that you are not studying Introduction to Business Law to be a lawyer but rather to obtain a basic understanding of the relevance of Business Law in the context of business and commerce, and also what you do in your personal life – for example, like shopping which is all about contract law, consumer protection and the tort of negligence.

By the end of this subject/unit, the hope we have is that you will have a basic understanding of how the legal system works and how laws are created, but also that you will be able to recognise a legal problem coming your way and be proactive in taking appropriate steps to ensure that the problem can be resolved in your favour.

> **Note:** The online reference materials, although referenced throughout this book, are supplementary and while not necessary, will help you to understand the core content of this unit. Further, all Acts and legislation mentioned can be considered PNG Acts and legislation unless otherwise indicated.

Chapter contents

As noted above, this subject/unit is hopefully going to provide you with an understanding of four different areas of law – negligence, contract, consumer protection and agency – that are useful for you in business and commerce, as well as being relevant in your personal lives.

The purpose of this Chapter is not only an introduction to what to expect in the coming 6 weeks but to also provide you with an overview of how to plan your study in the subject/unit, how to understand a case, how to read an Act, and how to write an essay.

See the table under the heading *What do you need to know about module readings?* to learn more about what readings to complete and when during the unit.

What is a study session planner?

The first thing to organise is a study session planner andthe second thing to do is to stick to it (so tick the boxes as you read through the planner).

Study session planner

Before you begin	**Suggested study time**	**Done (tick off)**
Find your way around the Blackboard site (try opening the URLs)	20 minutes	☐
Read the Unit Outline (it tells you about the Unit and learning resources)	10 minutes	☐
Read the Unit Content (it tells you what will be covered in the subject)	10 minutes	☐
Read the Learning Objectives for each Module	5 minutes	☐
Read the assessment (so you understand what you need to do to pass)	10 minutes	☐
Check out My Readings (so you know what to read and how big each chapter is [are you a slow reader or a fast reader?])	15 minutes	☐
Check out Learning Help (important if you run into problems)	10 minutes	☐
Total	**80 minutes**	

Now that you have your Study Plan sorted, have a look at the following suggested study sessions below for each Module. You really need to be disciplined and try and cover each topic in the time allocated (but you can adjust it as everyone reads at different speeds and writes different amounts of notes. Try and keep your notes short and to the point). Remember, a good set of notes is important when it comes to understanding, remembering and applying what you have read.

What is a module planner?

A module planner will help you track your progress in the unit. Use the following module planners to guide your studies over the next 6 weekly study sessions.

Module Planner – Topic 1: Introduction to law

Module 1 topics	**Suggested study time**	**Done (tick off)**
Introduction to the PNG legal system	90 minutes	☐
Sources of law	60 minutes	☐
The role of the police, the courts, and the parties	60 minutes	☐
Precedent and statute law	90 minutes	☐
What is negligence? – duty, breach, damage, defences, damages	7 hours	☐
Other areas of tort law and duty of care	90 minutes	☐
Revision question	2.5 hours	☐
Total study time	**16 hours**	

Module Planner – Topic 2: Making a contract

Module 2 topics	**Suggested study time**	**Done (tick off)**
Introduction to contract	90 minutes	☐
Agreement	5 hours	☐
Intention to create legal relations	90 minutes	☐
Consideration	3 hours	☐
Revision questions	2.5 hours	☐
Total study time	**13.5 hours**	

Module Planner – Topic 3: Validity

Module 3 topics	Suggested study time	Done (tick off)
Capicity	90 minutes	☐
Consent	3 hours	☐
Legality	3 hours	☐
Form	30 minutes	☐
Revision questions	2.5 hours	☐
Total study time	**10.5 hours**	

Module Planner – Topic 4: Construction of the contract

Module 4 topics	Suggested study time	Done (tick off)
Representations	90 minutes	☐
Parol Evidence Rule	90 minutes	☐
Collateral contracts	60 minutes	☐
How important is the term – conditions, warranties, innominate	2 hours	☐
Implied terms	2 hours	☐
Exclusion clauses	3 hours	☐
What is the standing of third parties?	90 minutes	☐
Revision questions	2.5 hours	☐
Total study time	**15 hours**	

Module Planner – Topic 5: Discharge and breach

Module 5 topics	Suggested study time	Done (tick off)
Privity of contract	90 minutes	☐
Discharge of a contract	3 hours	☐
Breach	90 minutes	☐
Frustration and force majeure	2 hours	☐
Remedies	3 hours	☐
Damages at common law	90 minutes	☐
Damages in equity	60 minutes	☐
Revision questions	2.5 hours	☐
Total study time	**16 hours**	

Module Planner – Topic 6: Consumer Protection and Agency

Module 6 topics	Suggested study time	Done (tick off)
The *Goods Act*	4 hours	☐
Independent Consumer and Competition Commission	60 minutes	☐
Packaging Law	60 minutes	☐
Commercial advertising	60 minutes	☐
Fairness of Transactions Act	2 hours	☐
What is agency?	60 minutes	☐
Different classes of agency	60 minutes	☐
Appointment of an agent and their authority	2 hours	☐
Obligations of an agent and principal	2 hours	☐
Termination of an agency agreement	90 minutes	☐
Remedies for breach	90 minutes	☐
Revision questions	2.5 hours	☐
Total study time	**20.5 hours**	

What do you need to know about module readings?

The times set down in the Module Planners above are approximate times it will take you to read through a topic. It is hard to be accurate when it comes to reading times because everybody reads at a different pace, however, the times above will give you a starting point.

The table below provides you with an overview of readings for each of the Modules. Try and read each chapter carefully. A highlighter can be very useful to highlight key points and things you might not understand. A good idea is to use two (2) different highlighter colours, one for key points and the other for what you don't understand. It makes revision much easier and the more you read, the more you will comprehend.

LEGL1007 Introduction to the Business Law of Papua New Guinea

Modules	**Readings**
Introduction	Chapter 1: Introduction to the legal system in Papua New Guinea
Module 1 *The Papua New Guinean Legal System and Introduction to Negligence*	Chapter 2: Legal Foundations Chapter 3: The Tort of Negligence
Module 2 *Making a Contract — Intention, Agreement and Consideration*	Chapter 4: Introduction to contract law Chapter 5: Agreement: Offer and Acceptance Chapter 6: Intention to create legal relations
Module 3 *Making a Contract — Capacity, Genuine Consent, Legality and Form*	Chapter 8: Capacity of the Parties Chapter 9: Genuine Consent Chapter 10: Legality of Object and Form
Module 4 *Construction of the Contract*	Chapter 11: Construction of the Contract: Terms and Conditions
Module 5 *Discharge and Breach of Contracts*	Chapter 12: Discharge and Breach of Contract
Module 6 *Consumer Protection and the role of agency in the supply of Goods and Services*	Chapter 13: Consumer Protection Chapter 14: Agency

Some tips on studying Business Law

What problems with words are you likely to encounter?

Studying a law subject is not quite the same as studying a lot of your other subjects/units. You will find that the chapters are different from what you are used to as a lot of the language appears, at first glance, to be 'foreign'. This is because the law is about language and how we interpret the meaning of words in documents, as well as Acts and regulations, from which we develop legal rules and principles. Here are some words to watch out for when reading legal documents, legislation, or texts.

'Means' versus 'includes'

Definitions of words and expressions in legislation will often commence with either 'means' or 'includes'.

- '**Means**' is used when the draftsperson wants the defined words to have an exact meaning. These can be found in the Interpretation section of an Act. For example, in the *Independent Consumer and Competition Commission Act 2002* s 2 states that *'Commission' means the Independent Consumer Commission and Competition . . .'* Thus, 'Commission' in this legislation refers to the PNG Consumer and Competition and no other commission.

- '**Includes**' expands or clarifies the ordinary meaning of a defined word by giving examples – for example, in s 2 of the *Independent Consumer and Competition Act 2002*, 'decision', when used as a verb, 'includes . . . declaration, determination, order, or other decision . . .'. The draftsperson has attempted to enlarge the ordinary meaning of 'decision' using the word 'includes' and the examples that follow.

'And' versus 'or'

The words 'and' and 'or' are commonly found in Acts, regulations, and legal documents.

- '**And**' is used when the draftsperson wants the words or phrases to be read together. All the matters or facts listed must exist, or if it is a requirement, all of them must be satisfied.
- **'Or**' is used to split words or phrases. The importance of the distinction between the two words is illustrated in s. 130(6)(b) of the *Independent Consumer and Competition Act 2002*, where the section states that a person who *'wilfully furnishes false or misleading records. . .*' is guilty of an offence. The effect of 'or' is to make it an offence

if you furnish false records, and similarly, if you furnish misleading records. Remove 'or' and substitute with 'and' and you can see the difference because now there are two requirements to satisfy.

'May' versus 'might'

- The use of the word '**may**' in an Act or regulation used in relation to a duty or power should suggest to you that the duty or power is discretionary, not mandatory, that is, there is a likely possibility that the duty or power will be exercised but it may not be.
- '**Might**' indicates an unlikely possibility that something is not happening and is the past tense of 'may'.

'Will', 'shall' and 'must'

The use of the words '**will**', '**shall**', and '**must**' in an Act or regulation are all used as verbs to express an obligation. Context is important and you need to consider three principles when you come across one of these words in an Act or regulation (or in correspondence such as a commercial contract):

- What is the natural and reasonable meaning of the sentence or clause?
- What did the parties intend?
- What makes the most sense in an Act, regulation, or commercial contract?

'Must' always suggests an absolute obligationand is now commonly used in all legal documents. It means you have no choice but to do it. 'Will', refers to a personal promise and in a contract reflects the future tense, that is, it is predictive. It doesn't create an obligation to perform. 'Shall', like 'will', is also predictive rather than obligatory, and future tense. It is confusing because it can mean 'may', 'will', or 'must' depending on the context it is being used in. But in legal drafting, it expresses a third party's positive or negative obligations and is a command.

'Could', 'would,' and'should

These are the past tense of 'shall', 'will', and 'can'

- In the case of '**could**', this is generally used to suggest a possibility or to make a request – for example, 'Could you please pass that book?' 'Could' suggests you could do it, but you might not want to.
- '**Would**' is used to refer to a possible or imagined situation, often used when that possible situation may not be going to happen: 'When would you have time to read a chapter before class?'

- '**Should**' is the conditional form of shall and implies that something ought to be done, or to express something that is probable, for example, 'Your book should be here after lunch?', or to ask a question, for example, 'Shouldn't you read this chapter before class?'

What does 'reasonable' mean?

Here is another word you frequently encounter in law, but do you know exactly what it means? You will encounter the reasonable person referred to on numerous occasions as you cover the materials in this subject/unit. To establish a breach of the duty of care the court must be satisfied that the risk was foreseeable, not insignificant, and what would a reasonable person have done in the circumstances.

The court will consider the meaning of 'reasonable' according to the circumstances and consider:

- The more serious the harm, the more likely it is that the reasonable person would take greater precautions
- The more probable the harm, the more likely the reasonable person will take precautions
- If there is little prospect of harm occurring, the more likely it is that the reasonable person will not take any precautions, **and**
- If the potential benefit of the defendant's actions or inactions is greater than the risk of harm to others, a reasonable person is less likely to take precautions.

So how do the courts deal with interpreting language? They generally resort to the following rules:

- words will generally be given their normal dictionary meaning (if you come by a word you haven't seen before, get a dictionary or look it up online)
- technical words are generally given their technical meaning
- words are interpreted according to their current meaning
- if a word is used more than once, it should be given the same meaning unless a contrary intention exists in the Act, and
- a statute should not be given retrospective effect unless expressly provided for in the statute. Parliament has the power to make laws but the problem with it is that Parliament is making a law today to apply to an act or omission that was legal when you did it yesterday. Do you think that is fair? Most legislation is proactive because it only alters the direct legal consequences of future events or actions.

The Courts

How do you find and reference a case?

If you need to find a case, there are two options: go to a law library or, much easier nowadays, use the internet and the databases online.

Online reference

Find a case online

If you do ever need to find a case online, go to the Papua New Guinea Primary Materials on the Pacific Islands Legal Information Institute website. See also recent cases and updates for the Supreme Court, National Court, and District Court (and cases in 2022).

If you need to find a case, the name of the case is followed by:

- the year of publication
- the initials of the court making the decision, **and**
- the judgment number.

For example, if you needed to find the case of *National Housing Corporation v Kipoi* all you need to do is type in the name in whatever search engine you use and you will see the name and URL for the case. Click on it and you will get taken to the site for National Housing Corporation v Kipoi[2021] PGSC 116.

If the case is not available online, reference needs to be made to a set of traditional law reports. Law reports have a slightly different citation to the electronic one. Each report has its own citation, and a law librarian will be able to direct you where to find the relevant report. Try the library at the PNG Supreme Court located in Waigani, which has both a print collection and an electronic legal collection or the Law School library at the University of Papua New Guinea.

When it comes to including a case in an assignment, or an answer to a legal problem, some basic principles should be kept in mind. These include:

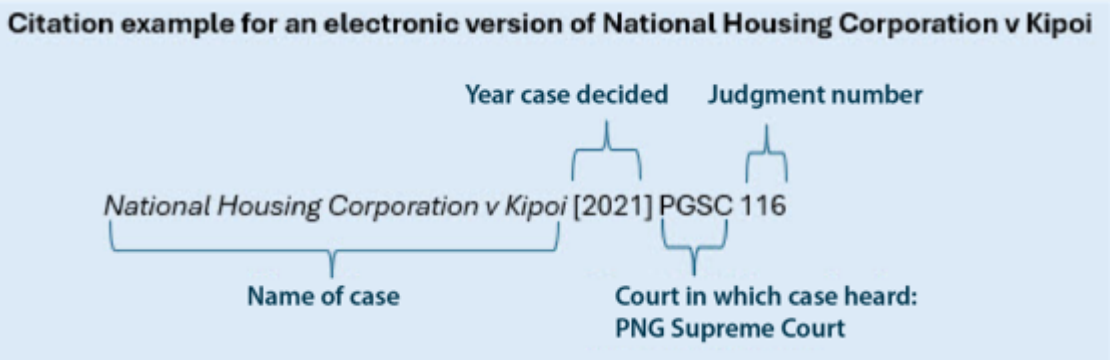
- The initial case name (citation) must appear in full – for example, *National Housing Corporation v Kipoi ('National Housing')*. If there is no reference to a specific page in the case, and as this case now appears in an online version it would appear as: *National Housing Corporation v Kipoi* [2021] PGSC 116 ('*National Housing*').
- If there is a reference to a specific point in the case, the reference to the citation would be to the paragraph number and it would appear as: *National Housing Corporation v Kipoi* [2021] PGSC 116 at [8].
- Any further references to that case can then be in abbreviated form, as in footnote 2 here:

1. *National Housing*,above n 1, [9].

Note: The footnote above is an example based on AGLC4 referencing style. This referencing style is not used throughout this text.

See a citation example below in Figure 1.

Figure 1: Citation example for an electronic version of National Housing Corporation v Kipoi. Image description.



Source: Gibson A (2024).

Finding the *ratio decidendi* (reason for deciding) and *obiter dicta* (sayings by the way)

It is useful to just briefly explain the meanings of two key terms that you will come across in reference to cases and there is more on this in Chapter 2 in relation to what we call precedent.

The**ratio**of a case is the reason for the decision. It is the reason/s for a judge's decision in a case based on a ruling on a point of law deduced from the facts of the case as presented to the court. It is not a statement of the law. **Obiter**(or sayings by the way), on the other hand, are remarks made by judges that do not affect the decision in the case.

An excellent case that illustrates how these rules work is an English case called *Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465* which expanded the law of negligence (what is known as a tort) to a new area of the law of negligence to include negligent misstatements, which caused pure economic loss.

If you are ever in the position of having to find either the ratio or examples of obiter (or both) in a case take the following steps:

- First, what were the parties asking the court to decide – the issues in contention?
- Secondly, read the whole judgment.
- Finally, what is the court's reasoning in determining the case's outcome?

Parliament

How do you find Acts and regulations?

As you will read in Chapter 2, the second main source of law within the PNG legal system is statute law and all three levels of government – national, provincial, and local – have legislative powers under the Constitution and the Organic Law on Provincial Governments and Local-Level Governments.

The three levels of Parliament each have their own distinct law-making powers. The powers that are not specified are assumed to remain with the national government. Provincial and local-level government powers are subordinate to the national law and have legislative power allowing them to pass legislation, but only to the extent that the national interest requires, otherwise they have relative autonomy in how they are to operate. It is worth noting that the powers of local-level governments are subject to the powers of provincial governments.

The law-making powers of the National, Provincial, and Local-Level Governments are set out in the Constitution of the Independent State of Papua New Guinea, while a list of Organic Laws can be found online at Papua New Guinea Organic Laws(the law-making powers of the Provincial and Local-Level Governments can be found in the Organic Law on Provincial Governments and Local-Level Governments).

Online resources

Find Acts and regulations

Legislation can be found at Papua New Guinea Sessional Legislation but the best site is the National Parliament of Papua New Guinea.

If you want to find an Act or regulation, and you will find numerous references to Acts (or statutes) and regulations in business, it is useful to know how to be able to find copies. Do notrely on another person's copy unless you are confident it is a copy of the most recent copy. Similarly, do not rely on what a person states about how or why an Act or regulations apply unless you know what they are talking about. Why? The reason for being so pedantic is that if you are relying on an Act or regulation to make your case, or to be used as a defence in court, and you have been given the wrong information because you didn't check, you might lose the case, so always check.

In brief

Some key points to note about legislation

- Acts and regulations are made by the three levels of government in PNG (and any subordinate bodies to which the Parliaments have delegated power to legislate).
- They are supreme law.
- In the event of a conflict with the common law, statute law prevails.
- They assume the existence of common law and often reaffirm common law principles.
- They can modify or replace the common law.
- They can respond more quickly to change to meet current community needs than the common law.
- They can be made retrospective and apply back in time.
- Because of the increasing complexity of legislation, doubts about the meaning of a word, phrase, ambiguities, or the extent of the operation of the Act itself will arise.
- Their titles are proper nouns and therefore commence with a capital letter, for example, the *Goods Act 1951*. Similarly, the word 'Act' is a noun and always begins with a capital 'A'.

How do the courts determine the meaning of an Act or regulation?

Because Acts and regulations are made up of words, you don't give a great deal of thought to their purpose in a sentence. Remember the example above of 'false and misleading' versus 'false or misleading'? Substitute 'or' for 'and' and vice versa in a paragraph and note the difference. Now, what happens with Acts and regulations? Can you have similar problems with the meaning of a section in an Act or regulations? The answer is 'yes'. So how do the courts deal with this type of problem?

To assist the courts (and you) there are rules for interpreting legislation. It is useful knowledge to have when you are in business because of the increasing role of statutory regulation by the three levels of Parliament in PNG in how business is to be conducted.

The tools available to the courts to use when the question of statutory interpretation arises include:

- rules of statutory interpretation (see for example, s 109(4) of the *Constitution of the Independent State of PNG 1975)*
- *Interpretation Act 1975*
- maxims (or aids to construction), **and**
- precedent.

In *Gari Baki v Allan Kopi*[2008] PGNC 251, N4023 the then Deputy Chief Justice Sir Salamo Injia at [16]:3 suggested the correct approach insofar as the principles of statutory interpretation were concerned was settled:

> "The Court must give effect to the legislative intention and purpose expressed in the language used in the statute. If the words used in the statute are clear and unambiguous, the Court must adopt the plain and ordinary meaning of those words. There is no need for the Court to engage in any statutory interpretation exercise. If the words are not so clear or ambiguous, the Court must construe the words in a fair and liberal manner in ascertaining their meaning and give an interpretation which gives meaning and effect to the legislative intention in the provision. The purpose of words or phrases used in question should be read and construed in the context of the provision as a whole. The Court should avoid a technical or legalistic construction of words and phrases used in a statutory provision without regard to other provisions which give context and meaning to the particular word (s) and phrases in question."

If the meaning and intention of the legislature is clear in the statute, the courts need to do no more than give effect to those words in the context of the Act.

An example of the literal approach can be found in the English case *Fisher v Bell* [1961] 1 QB 394 (the citation stands for Volume 1, QB stands for Queen's Bench and 394 the page number of that volume), at that time the *Restriction of Offensive Weapons Act 1959*(UK)

made it an offence for a shopkeeper to display a flick knife in a shop window, the relevant section stating 'Any person who sells, lends or gives a flick knife to any other person commits an offence.'

The court concluded in this case that the shopkeeper was inviting people like yourself who might have been walking past the shop to make an offer if they wanted a flick knife – that is, a sale would only be made if the shopkeeper accepted your offer. So, no breach of the Act occurred because you didn't go into the shop and make an offer to the shopkeeper. As an aside, the case was also interesting because selling a flick knife was a criminal offence and the court applied contract law to see whether an offence had occurred.

However, if the words in the Act lead to an absurdity, injustice, or repugnancy, or the words or phrases are ambiguous, vague, or uncertain, the courts today look at what the statute was intended to remedy and attempt to choose a meaning that will try and avoid an inequitable result but looking at what was Parliament's purpose or intention in passing the Act or regulations in the first place.

The courts will try and interpret the words in the legislation in a way that will help the legislation achieve its purpose where – for example, a literalist approach may leave the words ineffective and defeat the purpose of the legislation. The purpose rule was given pre-eminence by s 39(2) of the National Constitution, directing the courts to consider the objects and purposes of an Act when interpreting its provisions.


Online reference

See also the Supreme Court Bench Book at 5.8 Statutory Interpretation.

An example of a section of an Act that, because of the way it was drafted, caused problems in applying it was the English case of *Lee v Knapp* [1967] 2 QB 442. Lee was involved in a motor vehicle accident. He briefly stopped and then, seeing no one was injured, drove off. Section 77(1) of the *Road Traffic Act 1960* (UK) read:

> 'If in any case, owing to the presence of a motor vehicle on a road, an accident occurs whereby … damage is caused to a vehicle … other than that motor vehicle the driver of the motor car shall stop'

What do you think? Did Lee breach the section? Does a literal reading give you a sensible result? What was the purpose of the section or intention of Parliament?

The UK Parliament repealed the *Road Traffic Act 1960 (UK)* in 1988 with the *Road Traffic Act 1988 (UK)*. It now requires that a driver involved in an accident has a:

- *"Duty to give a name and address*
  - 168. Failure to give, or giving false, name and address in case of reckless or careless or inconsiderate driving or cycling

- *Duty in case of accident*
  - 170. Duty of driver to stop, report accident and give information or documents

- *Other duties to give information or documents*

  - 171. Duty of owner of motor vehicle to give information for verifying compliance with requirement of compulsory insurance

  - 172. Duty to give information as to identity of driver etc in certain circumstances."

Is the *Road Traffic Act 1988* Act clearer to you now than the *Road Traffic Act 1960* Act? Can you find similar legislation in PNG? Don't forget to check not only for relevant statutes but also regulations such as the PNG Road Traffic Rules – Road User Rules 2017.

One final comment on Acts and regulations is that they generally carry their own definitions of terms. They are set out in a definition section that appears either at the beginning of the Act or regulation at the end as a Schedule. These are often terms that recur throughout the various sections of the statute and that the draftsperson felt needed clarification.

The use of extrinsic evidence

The courts may refer to extrinsic (external) material in the interpretation of provisions of Acts and regulations, such as:

- parliamentary debates
- headings, margin notes and end notes of the legislation under scrutiny
- reports of Royal Commissions, Law Reform Commissions and committees of inquiry that have been tabled in Parliament
- treaties or other international agreements referred to in the Act
- any explanatory memorandum attached to the bill
- any document declared by the Act to be relevant, and
- anything recorded in the official reports of the proceedings of Parliament.

Maxims

Maxims are not rules of law but, rather, are aids or guides to construction. While the draftsperson tries to define words in such a manner that every possible interpretation is covered, no definition can be exclusive or perfectly describe a class of people, things or acts.

There are several maxims available to help the courts determine the meaning of a word or phrase, although the all-important matter is to consider the purpose of the legislation. Two of the more important maxims are:

- *noscitur a sociis* ('it is known from its associates'), **and**
- *ejusdem generis* ('of the same kind, class, or nature').

Noscitur a sociis

Noscitur a sociis, or the context rule, means that the words of a statute are to be construed in the light of their context. For example, in the English case of *R v Ann Harris* (1836) 173 ER 198, the words '*If any person unlawfully and maliciously shall shoot at any person, or shall, by drawing a trigger, or in any other manner, attempt to discharge any kind of loaded arms at any person, or shall unlawfully and maliciously stab, cut, or wound any person with intent in any of the cases aforesaid to maim, disfigure, or disable such person or to do some other grievous bodily harm to such person . . .*' were considered by the court to cover only wounding by a weapon, not by hands or teeth. Any comment on the decision?

Ejusdem generis

Ejusdem generis is a subset of the rule *noscitur a sociis* and is known as the class rule. This rule is used to find a viable meaning for a broad, general word, such as 'building', when that word follows a group of more specific words – for example, 'any house, flat, villa, unit or other building' – and is based on context. In this case we can say that the principle of *ejusdem generis* applies. The word 'building' is limited to the same class as that which precedes it—here, places where people live. All the specific words preceding a general word must form a class. Thus, a reference to 'any plant, root, fruit or vegetable production growing in any garden' does not extend to trees, since there is no class here.

The class rule cannot be used:

- to find the meaning of a word that is of a specific nature
- unless there are two or more specific words before the general word.

Thus, in the case of the phrase 'any flat or other building', the class rule does not apply, as 'flat' on its own does not form a class.

Dictionaries

If a word is not defined in the definition section of an Act or regulations, a dictionary can be

referred to – for example, search the university library catalogue for an online dictionary or use any hardcopy dictionary you have.

How do you write a good law essay or answer to a problem question?

An essay is a common type of assessment for a unit like Business Law. This resource offers tips and resources to help you plan and write law essays. There are usually two types of law essays: the **problem-styleessay** and the **theoretical basedessay**.

The theoretical based essay may ask you to critically discuss a new piece of legislation or a recent case in relation to existing laws or legal principles. You may also be asked to take a side in an argument or discuss the wider societal implications of a legal outcome.

Problem-style essays require you to advise a party based on the analysis of a scenario or given problem. You will be required to identify the legal issues and apply relevant law.

Problem questions and essays

Begin by making sure you understand the question. It sounds obvious but read the question a couple of times and if you are still not sure please ask your tutor for assistance.

As you read the question, consider the following points (and use a highlighter to mark up what you consider to be key issues):

- Read the lecturer's instructions before you start to look at the question and note down:
  - the due date, and
  - the word limit. If you go over the word limit you may get penalised; if you go too far under there is a possibility that you haven't covered everything.
- What is the question asking you to do, for example, critically analyse, discuss, explain? Is it an essay or problem-based question?
- Think about what general area/s of law the question is focussed on? An essay question will tell you, but a problem-based question will leave you to work out what the relevant area of law is.

Answering a problem question or essay

In a problem question, you are normally given a fact situation and asked to explain what the legal outcome would or should be. There might be one issue or a series of issues in the one scenario. Hence the reason to read the question carefully a couple of times.

If the question is a problem question, most Universities in Australia have adopted the **IRAC** (**I**ssue, **R**ule, **A**pplication, **C**onclusion) method or style. In using this method, you will:

- Identify the legal **ISSUE/S** that arise in the question, stating the legal conclusion that needs to be reached and connecting it to the relevant facts in the question.
- Identify and explain the relevant legal **RULES** that apply in this problem – that is, what general law/s or test/s apply. You are not arriving at a conclusion at this point though.
- **APPLICATION of the legal rules** is where you are going to explain how the legal principles (RULES) can be applied to the facts. It is not enough to state the rules. You must link the rules to the facts.
- In your **CONCLUSION** concisely state the outcome of each issue you identified in the problem. This is based on the application of the rules to the facts. Then provide an overall judgment. DO NOT MENTION ANYTHING NEW. Your conclusion should explain to the reader why you have come to this final judgment.

Answering essay questions

Plan the essay

Begin by making a plan. Consider the topic and make sure that you understand it. Think about what the question is asking you to do. It may be necessary to have done some reading around the topic before you can understand the issue/s. But having a plan will help you with the structure and order of discussion of the essay when you come to write it

Just as an aside, the aim of background reading is to help you understand the context of the assignment question. Begin with general sources first and then more specific ones. Take notes as you go along as that helps you to understand different arguments and issues, or information and context, relevant to the essay. And a tip here is to be sure when taking notes that you make a note of the source so that you can correctly cite it in your essay. Remember you don't want to be accused of plagiarising.

Don't forget that the purpose of an introduction is that it should be an outline of the structure of the essay and prepare the reader for the topic. This should include the central argument of your essay and the key arguments which will form the main part of the essay. Its purpose is to make the reader want to read on and see whether they agree with what you are going to argue.

Structuring your answer

A key element of a successful law essay is the structure. A good structure will enable you to communicate your ideas fluently and efficiently and is an important skill in business.

Make a list of key and supporting arguments and decide on their order. Generally, your essay requires an introduction, body paragraphs, and a conclusion. Try and use headings and sub-headings (three to six words) in the main body of the essay for each of your supporting arguments. This helps the reader to see where you are taking them (and it helps you ensure that you have covered everything you wanted to cover).

The advantage of using sub-headings is that it not only helps in providing structure to your writing but it also provides you with a structure to follow. If you are struggling to know at this stage what the exact content for each paragraph will be, simply list relevant material you have found while reading, and list any cases and sections of statutes/regulations which may support your arguments in each paragraph.

Try and have one idea per paragraph and aim to keep the paragraphs shorter than what you probably would have written in high school or other Faculties.

Conclusion

Do not introduce any new material into your Conclusion. The Conclusion reviews what you have written for the question. It should begin by rephrasing or restating the main argument/s of the essay butin a different way. It summarises the essay's main arguments, gives final thoughts about the topic, and provides closure for the reader. If you are struggling to write an Introduction, try writing the Conclusion and then writing the Introduction last.

Achieving success

In order to do well, plan your work so that you can complete the final draft a few days before it is due for submission. This gives you time to ensure that your essay reflects good academic standards and is not an example of last-minute hasty work. Make sure footnotes are included, citations are correct, headings and subheadings are appropriate, that the essay is in 'plain English', and that there are no grammar or spelling mistakes.

Always try and get a third party to proofread your work before you submit it. When we proofread our own work, we often don't see spelling or grammatical errors because we are seeing the text from our memory and not what is written in front of us. Get a friend to check your work for you.

Markers highly value closely edited and proofed work. Poor grammar and/or spelling mistakes can be extremely costly as the marker has to struggle to understand what the writer is saying. A lot of marks can be lost here. Good students write in clear and concise English that is easily understood.

Summary

This introductory chapter was originally intended to be a brief chapter on helping you navigate your way through a range of commercial law topics that you need to have an understanding of if, first, you want to pass easily, and secondly, which you can use later on in business or your personal life.

The problem was that to understand areas such as negligence (a tort), contract law, consumer protection and agency you really needed to understand that reading is terribly important. The more you read, the better you will understand. But even while the more reading you do is great, you must also understand the importance of the use of words like ‘and’ and ‘or’, ‘must’ and ‘may’, and so on, and as you read you can appreciate their importance.

You also need to understand where the law comes from, hence the reason why we have included a commentary on the courts and help with how to find a ratio and obiter as they form the basis of common law, as well as how to interpret Acts and regulations.

What you need to understand at the end of the day is the role law plays in your lives and that ***ignorance of the law is no excuse***.

Reference list

Gibson A (2024) *Citation example for an electronic version of National Housing Corporation v Kipoi* [Figure 1].

Image descriptions

Figure 1 image description: Citation example for an electronic version of National Housing Corporation v Kipoi. The Name of Case is National Housing Corporation v Kipoi; the Year the case decided is [2021]; the Court in which the case is heard is PGSC, which stands for Papua New Guinea Supreme Court and; the Judgement number is 116. Return to Figure 1.

2.

LEGAL FOUNDATIONS

Learning objectives

On completion of this chapter, you should be able to:

- understand the importance of the law in our lives
- understand what 'law' is and how it is created
- identify the main sources of PNG law

Key terms

You will encounter some key terms in this chapter, which will help you to better understand the law and this chapter. These terms are:

- **Civil law system**: a complete legal system with its origins in Roman law and the Napoleonic Code.
- **Common law:** that part of English law developed from the common custom of the country as administered by the common law courts.
- **Customary law:** the term used to describe the common law rights and interests of tribal people in land according to their laws, traditions and customs.
- **Equity:** fairness or natural justice.
- **International law**: that body of law concerned with regulating conduct between nation states.
- **Municipal (or domestic) law:** that body of law concerned with regulating the relations or conduct between individuals and organisations within a state's borders.
- **Organic law:** defined in s 12 of the PNG Constitution as laws passed by the National Parliament and which have the status of constitutional laws and are superior to an Act of Parliament.
- **Plaintiff:** the party commencing a civil action in a court of first instance.

- **Private law:** that body of law concerned with regulating the relationships between individuals within the state—for example, contract law and tort law.
- **Public law:** that body of law concerned with the relationship between the state and the individual—for example, criminal law and constitutional law.
- **Retrospective laws:** laws that change what people's rights were in the past.
- **Separation of powers:** the vesting of the legislative, executive and judicial arms of government into three separate branches with none of the three branches able to exercise total power.
- **Statute law:** laws passed by Parliament.

Introduction

This chapter contains background information on the PNG legal system. It is not exhaustive as we would need a book for that, but it will provide you with a basic understanding of what is 'law', how laws are made, its role, the major and minor types of laws that make up the PNG legal system and understanding the role of Parliament and the importance of the Constitution. This chapter has been divided into 6 parts to make it easier to understand, however it is not exhaustive.

Part 1: Why is an understanding of law important in business and life?

This chapter will help you understand your legal system and how it impacts on you both in business and your personal life. The interesting thing about the law is that you and it are in almost constant contact every day but, like a lot of people, you don't realise it and understand it. So here is a question to think about: is a basic understanding of the law such a foolish thing?

What is the importance of the law as a regulatory tool in society and business?

Law is basically a device to regulate the economic and social behaviour of people like you who live in a society. If people lived in complete isolation and didn't carry on any economic activity or recognise any superior authority, there would be little or no need for laws to exist because there would be little to regulate or control. Think about life in a remote village in the Highlands and then about life in a city like Port Moresby. Is there the same level of regulatory control in both, or needed in both?

In most nations around the world, people don't live in complete isolation and business activity is carried on regardless of whether people like it or not. If you live in a city or town, you depend on the existence of businesses for work and money, and for the purchase of goods and services for your survival. What do you think would happen if there were no rules to regulate business or what you could do as a member of the community? This is where the law comes in.

The law, as a regulatory device, provides the mechanism for society to function by prioritising needs and desires through tools such as legislation (Acts and regulations of Parliament) and custom or customary law.

When you look more closely at the PNG legal system, it has what can be best described as a dual legal system with a formal court system and a customary court system which generally applies in two broad areas: marriage and land ownership. The latter is recognised by the PNG Government because many villages, for example, in the Highlands, prefer to resolve disputes in a traditional way rather than more formally through the courts.

Can we define the term 'law'?

We should begin by trying to explain what the term 'law' means. In trying to do this just accept that it is not easy as evidenced by the numerous unsuccessful attempts to produce a universally acceptable definition of 'law' over the centuries. Yet, despite this lack of agreement on a precise definition of 'law', it is still possible to identify two common themes:

- control by humans like us; and
- human conduct, regulated by a superior authority or power—in this case the government of PNG and the elders of villages.

So, let's not be too academic and go for a general definition:

. . . a set of rules developed over a long period of time regulating people's interactions with each other, which sets standards of conduct between individuals and other individuals, and individuals and the government, and that are enforceable through sanctions.

In the case of PNG, 'the supreme laws' are contained in **The Constitution and Organic Laws** (which have the status of constitutional law *see section 11* (s 11) of the National Constitution). But in addition, there are rules and principles of conduct that are enacted by government including the Bougainville Constitution and legislation, organic laws of PNG, local-level government, decisions of the courts, and customary law.

We should note that when a reference is made to '*the* law', it is a reference to the body of law generally, while a reference to '*a* law' is a reference to a particular legal rule.


Online Reference

If you have access to the internet, have a brief look at the Constitution of the Independent State of Papua New Guinea and see if you can locate section 11 (s 11) as mentioned above.

Are rules always law?

While it is generally true to say that the law is a set of rules, do not assume that all rules are (or will be) automatically law. There are numerous examples of rules governing daily behaviour that are not laws and, generally will not become laws—for example, rules controlling sport, playing games, social behaviour, family behaviour, or how a person should behave at school and university. The list is endless. But just remember that while these rules are not intended to be legally enforceable, it does not mean that they cannot finish up in court in the event of a dispute arising over the rules, particularly in sporting contests.

To determine when a rule becomes law isn't always an easy task. Consideration needs to be given to where the rule comes from. If it is made by a person or organisation rather than by parliament or the courts, it generally cannot be said to be a rule of law.

So where do tribal laws fit in? Are they part of the legal system? In the case of PNG, they are part of custom or customary law and expressly provided for in the Constitution (see Schedules 1.2 and 2.6 of the National Constitution).

When looking at the 'law' in PNG, it should be noted that tribal connections are at the core of PNG's culture. This is not going to change in a hurry as customary lawhas still got a significant role to play in the community.

What is the role of the 'law' as a regulatory tool?

In society generally, the law as a regulatory tool not only prescribes what people like you *cannot* do, it also informs you of what you *can*do and what you *must*do. For example, you *cannot*commit a crime, but you *can*own property, and you *must*pay taxes. But the law also plays a number of other roles, such as guaranteeing your freedom, permitting free

enterprise, establishing rules for business and commerce, and providing a means to settle disputes peacefully.

Could business exist without a legal system?

Do you think business, as you know it, could exist without the law? To operate effectively and efficiently, you need to understand that business needs laws to regulate business activities, to facilitate business transactions and to settle disputes that can arise between manufacturers, wholesalers, retailers and consumers (like you) of goods or services.

As we noted at the outset to this chapter, there are very few aspects of life—business or personal—that are not regulated by law, either directly or indirectly, in developed countries like Australia.

In countries like Australia, England, America and other developed countries, laws shape every stage of commercial enterprise. Because people are constantly engaged in business transactions, an understanding of business law is important and this is equally true in those areas of PNG where there is commercialisation, as in shops and industry. As you will discover, the principles of contract law, for example, enable both individuals and businesses to rely on agreements:

- of employment
- to purchase raw materials
- for the purchase and sale of goods or services
- for the purchase of a home or a business
- to insure property
- for the appointment of an agent
- to catch a bus or to purchase a plane ticket
- to buy food and fuel
- to buy clothes
- to go to the movies, and so on.

So, when things go wrong, they provide a remedy to persons ‘injured’ (they have lost money or suffered some other form of loss or damage) by another’s failure to perform an agreement.

Reflection

Think about your country for a moment. Do you think PNG is a highly regulated country? Look at the type of regulatory frameworks currently in place.

Part 2: What are the sources of law in PNG?

The laws of PNG consist of the National Constitution and any laws made or adopted by it and the Organic Laws (which together are the supreme law of PNG), Acts (or legislation) of Parliament, the Provincial Laws, customary law, common law and equity.

Common Law

This is lawcreated through the reported decisions of judges(the doctrine of precedent or case law) in the higher courts (which in the case of PNG are the National Court and the Supreme Court). It is non-statutory law and based on decisions that were made about similar cases in the past. It is *law made by the courts, not parliament*,and it usually includes the principles of equity or equity law (or fairness). It has both a criminal and civil jurisdiction.

In a civil case, for example, you have been injured because of the carelessness of another person, the onus of proof rests on you as the plaintiff to establish on the balance of probabilities that your claim is stronger than the person who caused the injury (the defendant). This is a lower burden of proof than required in a criminal case where the onus is on the Crown to prove a case against an accused beyond reasonable doubt.

The role of the judge in this case is to decide questions of law unless there is no jury (who would decide questions of fact) although it has become increasingly common for judge only trials because of the complexity of commercial cases coming before the courts.

The concept of precedent is fundamental to the functioning of the common law system. Remember that there are two kinds of precedent:

- **Binding precedents** are past decisions of superior courts which must be followed by judges in other similar cases by that court and lower courts in the same jurisdiction (as

long as facts of the case are sufficiently similar)
- **Persuasive precedents** are ones that should be seriously considered, but which are not required to be followed because they might be from a superior court in another hierarchy (for example, a decision of an Australian court such as the NSW Court of Appeal as it is a different jurisdiction).

The emphasis is on remedies, usually in the form of monetary relief (or compensation) and is available 'as of right' under common law.

Equity

Equity is a separate body of law from common law and in the event of a conflict between the common law or equity, equity will prevail. It is a *discretionary remedy* available to the court when monetary damages, which are a common law remedy, might not achieve a fair outcome for a plaintiff.

Equity law does not apply to all civil disputes, and it has no application in criminal law. Where equity might apply is where the injured party (the plaintiff) does not want damages because it is not 'as of right') or where there is an unconscionable dealing by a stronger party in a contractual situation. Unlike common law, equity is not available 'as of right'and it involves a plaintiff coming to the court in good faith (as in, based on fair dealing and asking the court to exercise their discretion in granting an equitable remedy.

The two main types of equitable remedy, which are court orders are:

- an injunction: a court order that directs a person to stop doing something that could harm the interests of another and may be granted as a temporary order (called an interlocutory injunction) before the court makes a final order in the matter, or as a final injunction; and
- specific performance: a court order directing a person to carry out an obligation that they have accepted, often in a contract—for example, to complete a sale of land. It is not available where the contract requires a personal service such as an employment contract because of the difficulties created for the court to supervise.

What are the differences between common law and equity?

Common law	Equity
1. A comprehensive system	1. Not a comprehensive system—for example, it never had a criminal jurisdiction.
2. Remedies are not discretionary – damages	2. Remedies are discretionary
3. Common law rights are enforceable at any time, subject to the operation of the Fraud and Limitations Act 1988	3. Remedies must be applied for promptly or they may not be enforceable
4. Common law rights are valid against the whole world.	4. Equitable rights are valid only against those persons specified by the court.
	5. Follows the common law; it will not override it except where there is a conflict and then equity prevails.
	6. Acts only against the individual (that is, in personam), not property.

Statute law

Statute laws are laws made by parliament, such as the National Parliament in PNG, in the form of statute law or legislation(also known as enacted law) or other government bodies in the form of by-laws, orders, rules and regulations, and known as delegated legislation.

The laws created by Parliament are the highest ranking in the land, overruling all other laws. As noted earlier, while statute law assumes the existence of common law, in the event of a conflict between common law and statute law, the latter will prevail. Common law principles will be maintained only to the point at which they conflict with statute law.

The reason why statute law prevails is that judges are independent of Parliament (and the people), while politicians, who are responsible for the making of statute law, are accountable to the people through the electoral process. If people don't like the laws that the politicians make in Parliament, they can vote them out at election time. There is, therefore, a degree of accountability as far as politicians are concerned which is absent in the case of judges because you can't vote out the judges. A judge can be removed from power only by reaching the age of retirement, or by misbehaviour or incapacity. It is largely for this reason that in the event of a conflict between statute law and common law, statute law prevails.

Customary law

Customary law is a body of rules and practices derived from the country's regional customs and which govern a community and their way of life. In the case of PNG, with its very diverse society in terms of its cultural practices and customs, each area in PNG has its own customary laws which, in addition to the western legal system they inherited from

European occupation, have been recognised and provided for in the Constitution and are now a recognized part of the PNG legal system.

So, what is customary law in the context of PNG? Its inclusion in the National Constitution preamble (Preamble, s 5) and sch 1.2 has established its place within PNG's legal system and provides a definition:

> *'The customs and usages of indigenous inhabitants of the country existing in relation to the matter in question at the time when and the place in relation to which the matter arises, regardless of whether or not the custom or usage has existed from time immemorial.'*

The same definition can also be found in the *Interpretation Act 1975*, s 1 and in 2000 when the PNG National Parliament enacted the *Underlying Law Act 2000*, which also incorporated the same definition of customary law in s 1.

Organic law

Organic or fundamental law is a system of laws which form the original foundation of a government and can include a constitution which is a particular form of organic law.

Organic Laws, which are part of the laws of PNG (*see s* 9(b) of the National Constitution) are defined in s 12 of the National Constitution as laws made by Parliament and in terms of status sit above an Act of Parliament in the context of importance. They can only be changed or repealed by another Organic Law or by alteration of the Constitution under s 13 and made and certified in accordance with s 14.

Online Reference

Examples of Organic laws can be found at Papua New Guinea Organic Laws. Anexample of an Organic Law is the Organic Law on Provincial Governments and Local-level Governments 2014.

Underlying law

Underlying law is a reference to the separate common law of PNG. It is made up of customary law and the common law of England (including the House of Lords, Court of Appeal, and the King's Bench) up to PNG's independence in 1975 (*Underlying Law Act 2000*, s 3(1)).

Underlying Law Act 2000 is an interesting Act as it sets out the sources, application, formulation and development of underlying law and the roles of the common law and customary law. It should be noted that insofar as underlying law and its application by the courts, s 5 provides that 'the courts, especially the Supreme Court and the National Court, shall ensure that, with due regard to the need for consistency, the underlying law develops as a coherent system in a manner that is appropriate to the circumstances of the country'.

Online Reference

The Underlying Law Act 2000 can be found online.

Revision questions

Time for a break. Give yourself constant breaks so you can have time to reflect on, and think about, what you have read. Write down your thoughts because they will form the basis of your notes:

A. Common law ceases to be common law when it becomes codified. What does this mean?

B. Common law can exist without equity, but equity cannot exist without common law. Can you explain why?

C. What is the main remedy in a common law action?

D. In the event of a conflict between statute law and common law which takes precedence, and why?

E. What is Organic Law and why is it important in PNG?

F. What is customary law and why is it important in PNG?

Part 3: What are the characteristics of a legal system?

To be effective and have widespread community acceptance, whether it be in PNG or anywhere else in the world, a legal system must have the following characteristics:

- clarity and certainty
- flexibility
- fairness and
- accessibility.

Does the legal system provide clarity and certainty?

The law needs to be as clear and certain as possible. It can never be absolute, but it should be predictable and flexible so that you, and people like you, as well as businesses can conduct their affairs knowing what the law is (or being able to find out what it is), and what the consequences of their actions will be if they follow or don't follow the rules.

In part, this need for certainty helps to explain why parliaments are reluctant to pass retrospective laws (laws that change what people's rights were in the past), as such laws can have the effect of making an act that was lawful at the time it was done subsequently unlawful. This, in turn, can produce elements of uncertainty or unpredictability in the community as well as unfairness in the legal system.

Is the legal system flexible?

If there is to be widespread community acceptance of the law, then the law must be seen as responsive, and adaptable, to changing circumstances—that is, it must be flexible.

If the law cannot respond or adapt to change in a timely fashion, then there is a real risk that it will become redundant because it is not meeting the needs of the community it serves and they will ignore it. Consider, for example, how the law has responded to the rapid advancement of technology or adjusted to changes in moral values within the community.

Is the legal system fair?

The law must be seen to be fair and just, at least by most members of the community. If the law is seen as inequitable, unfair, unreasonable or unjust, it will not be accepted or obeyed by the community. Widespread community rejection of the law inevitably leads to civil unrest, with members of the community taking it upon themselves to enforce what they perceive the law to be. In other words, members of the community take the law into their own hands, for example, the Port Moresby riots in January 2024.

A concept that is closely identified with the law is justice. It is highly desirable that there be some sort of relationship between law and justice, but do the terms ‘justice’ and ‘fairness’ mean the same thing? Unfortunately, ‘justice’ can be a difficult term to define. As Lord Denning(1955: no pagination), one of England’s greatest judges, suggested:

> *It [justice] is not a product of intellect but of spirit. The nearest we can go to defining justice is to say that it is what right-minded members of the community—those who have the right spirit within them—believe to be fair.*

A legal system embodies what society believes is right or fair. It protects our safety and protects our rights as members of the community against abuses by other people, organisations and even the government. In simplistic terms, a legal system is all about justice and it is supposed to mean that everyone is entitled to be treated fairly.

If a person breaks the criminal law or you are injured because of the actions of another—for example, someone robs you or the other person is negligent (a law of torts action) or they breach a contract you have with them—the community assumes that the legal system will ensure that the person who robbed you will be punished and that the person who injured you will compensate you for the damage they caused you. It is assumed by the community (and both parties) that should the matter go to court they will receive a fair trial.

As you are probably aware, there are many different types of laws. In PNG for example, there are three law-making sources – the National Parliament, the Provincial Parliaments

and local or village bodies. But which body do you go to if you want to find out what type of law might apply to your problem? Be aware that you may have a problem. Many of the laws currently in force in PNG are outdated, culturally inappropriate, lack operational effectiveness, are difficult to find, and are no longer relevant or up to date.

Don't believe that the PNG legal system is foolproof and just (or fair), because it is not. Humans are not foolproof, and nor are you as you make mistakes now and will continue to do so through life, and as laws are made by humans, they will not be foolproof either. As our society evolves, it is to be hoped that the legal system will also evolve and that existing injustices will gradually disappear and be replaced by fairness with the passage of time.

Is the legal system accessible?

The legal system is based on the premise that everyone is expected to know the law, which explains why it is not possible to argue, in a court of law, ignorance of the law as an excuse for breaking the law. But given the complexity of the legal system, is this expectation realistic?

The fact is that no one knows all the law. All we can assume is that everyone has access to the law. This can be through copies of legislation (for example, through the PNG government printer and Government Gazette) and cases (for example, law reports), the Internet, or through a lawyer.

Online Reference

A useful site for PNG case law and legislation (but note that Sessional Legislation is only including up to 2021) is Papua New Guinea Primary Materials.

Solving the problem of accessibility doesn't solve the problem of knowledge—that is, that everyone is expected to know the law. Accessibility doesn't equate with knowledge or understanding of the legal system. That only comes when you or a business can:

- **identify** the legal issue
- **determine** what area of law may apply

- **know** where to find information about the relevant area of law
- **understand** the relevant elements of legislation or a case
- be able to **understand and interpret** what was read
- **apply** the relevant legal rules to the facts.

A basic understanding of how the legal system operates reduces the possibility of a serious legal issue arising. But if such a problem arises anyway, an understanding of some basic legal skills will result in dealing with the problem in an opportune manner for a better result.

Revision questions

Time for another break. Think about what you have just read and try to answer the following questions:

A. What does the phrase 'ignorance of the law is no excuse' mean to you?
B. Is it reasonable to expect that everyone knows the law? Do you? How do you overcome this problem?
C. What are the benefits if you are in business of understanding the different legal systems in the world?

Part 4: Why should we classify laws?

An understanding of the main principles underlying each source of law is important when trying to understand how the law and business interact. But first you need to understand what area of law may be applicable to the matter you are dealing with.

Law can be classified in different ways depending on the purpose of the classification and the needs of the classifier. Common classifications include:

- by legal system
- international law and municipal (or domestic) law
- public law and private law
- substantive law and procedural law
- criminal law and civil law.

Are there other legal systems?

Do not assume that there is just one or two legal systems in the world of which one is the PNG legal system. Arguably, there are two major legal systems — a common law system (such as in PNG) and a civil law system (such as in Europe and a lot of Asia) — of the Western world. There are several other legal systems in existence around the world including dual systems (such as in PNG) which is made up of a formal court system and a customary court system.

If you are doing business overseas, either as an importer (or exporter or investor), there are political, economic and legal factors that you have to take into account. Where legal factors are concerned, you need to consider what legal system you are most likely to encounter. These legal systems could be any of the following:

Common law system

As noted earlier, the common law system is derived from case law (or precedent) and legislation. It is accusatorial in form and the burden of proof depends on the type of case. If it is criminal, the onus is on the Crown to prove their case beyond reasonable doubt while if it is civil, the burden of proof is on the plaintiff and they must establish their case on the balance of probabilities.

Civil law system

The civil law system is a comprehensive codified system of law with its origins in Roman law. In civil law systems, comprehensive legal codes and statutes are designed to cover every contingency and form the primary source of law. While case law exists in civil law jurisdictions, it is considered a secondary source and does not have the same influence as it does in common law systems.

Unlike the common law system, the civil law system follows an inquisitorial approach and it is the judge who asks questions, gathers evidence, determines the issues to be decided and applies the law. Juries are rarely involved in civil actions.

Socialist law system

The socialist law system is based on the philosophy of Karl Marx (as in the eradication of capitalism and the elimination of private ownership). With its emphasis on codes, means it is really only a variation of civil law but with an emphasis on public law. Like the civil law system, it is a complete code of written laws whose primary source of law is legislation. While it is inquisitorial in form and judges dominate trials, courts are subordinate to the legislature. It applies to more than 30 per cent of the world's population.

Islamic law system

Islamic law system has its roots in religious doctrine, particularly relying on the *Koran (or Qur'an)* which is the central religious text of Islam and believed by Muslims to be the literal words of God and, a complete code of conduct that provides guidance through life. In addition, there is the hadith (or Sunnah) which are the decisions and sayings of the prophet Muhammad.

Religion and Islamic law are intertwined to greater and lesser degrees depending on the country. What should be noted is that Sharia (which means the "correct path "in Arabic) isn't the same as Islamic law. While Islamic law is influenced by local customs and evolves over time, it is important to understand that Islamic laws are based on interpretations of sharia. The emphasis is on divine revelation and while it coexists with other laws, Islamic law encourages disputes to be resolved outside the court through arbitration (*tahkim*) and mediation (*sulh*). As an aside, it is interesting to note that where contract law is concerned, the emphasis is on fairness.

Islamic law applies to approximately 25 per cent of the world's population with most of the world's almost 50 Muslim majority countries having laws that refer to sharia.

Hybrid and dual law systems

Several countries have mixed legal systems which incorporate common, civil, and religious law systems into what is effectively a hybrid system that is unique to the country's needs.

As noted at the start to this section, PNG currently has a system that can be described as a dual legal system because it is made up of a formal court system and a customary court system. Currently, the dual system of law is not applicable to all sections of law. Generally, it applies to only two broad areas: marriage and land ownership, but this is not to say that the role of customary law within the legal system will not gradually increase over time with the growth of an indigenous Melanesian jurisprudential influence, as enshrined in the preamble of the national Constitution as goal number 5 of the Five National Goals and Directive Principles.

Online references

A quick and easy way to identify a country's legal system is to use the free website JuriGlobeLegal Systems. The World Factbook, a cia.gov website, is another source to learn about legal systems around the world.

Why is knowledge of a legal system important?

The purpose of providing an overview of some of the world's legal systems is to provide you with a better understanding of some of the complexities involved when dealing with other nation-States, since no two legal systems are the same.


Video reference

Why do countries trade? Look at this short video about what makes an economy grow.

Familiarity with the political and economic status, and the legal system, of a potential trading partner is essential. Businesses must abide by the local rules and regulations of the States in which they operate. Governments make and enforce the rules and regulations based on their political beliefs and ideologies. So, you may want to assess at least the following matters when assessing risk:

- How stable is the government?
- What sort of government is it – democracy dictatorship?
- Is the prospective country politically stable?
- What impact does the prospective State's political system have, if any, on the economy and, how may it impact on you, your firm and industry?
- What sort of legal system does the prospective State? Will you need to assess how local policies, rules and regulations will affect your business?

While all nation-States have a legal system, it is important to remember that there will always be differences in local policies, rules and regulations. You need to assess the level

of risk involved, balancing political, economic and legal realities with the need to control and manage trade.

In addition to the different types of legal systems, two further classifications of law are:

International law and municipal (or domestic) law

International law is that body of law concerned with regulating, for the most part, the conduct between nation-States. Nation-states like PNG could not enjoy the benefits of trade and commerce, exchange of ideas, or even normal routine communication without some system of international law and, it is only the nation-State which enter into international trade treaties and agreements with other Nation States that must abide by international law.

Three of the better-known trade agreements with PNG is a member are:

- **GATT** — the General Agreement on Tariffs and Trade is a multilateral treaty that aims to encourage free trade in goods and PNG has been a member since 1994 (and a member of the World Trade Organisation or WTO since 1996)
- the**Vienna Sales Convention** — this is a multilateral treaty that sets out standards of conduct for sales agreements between traders of signatory countries and PNG has been a member since December, 1994
- **APEC** — Asia-Pacific Economic Cooperation is a regional treaty that provides special trading advantages to its 21 member states. PNG has been a member since 1993.

Municipal (or domestic) laws come from statute orcase law. They regulate the relations or conduct between individuals(or natural persons) and organisations legal persons) that come within the nation state's borders. This doesn't mean that the individual or organisation must be a citizen of the state making the law, just that it must be within the nation state's borders. For example, if you live in PNG, you are subject to the municipal or domestic laws of PNG. But if you visit Australia, you become subject to the municipal or domestic laws of Australia.

Public law and private law

Public law is concerned with the organisation of government and the relationship that exists between the government and the people. The areas of law that form part of public law — such as administrative law, constitutional law, criminal law, industrial law and taxation — are areas in which the public has a determining interest.

Private law is concerned with those areas of the law that deal with situations involving disputes over rights and obligations between people or organisations. There are numerous branches of private law, but some of the more important areas that are relevant to business

that you will encounter (and will discover in the following chapters) include contract law, commercial law, negligence (law of torts), consumer law and agency. But do not think that this list is an exhaustive list of areas of law relevant to business because it is not. It does not included areas such as corporations law, partnerships, property law, negotiable instruments, trusts, and taxation to mention but a few.

Is a knowledge of criminal law important?

To date the focus has been on civil law but it would be wrong to assume that criminal law is something you don't need to worry about in business. There is an increasing amount of legislation relevant to business that carries criminal penalties, particularly in the area of corporations, work health and safety and consumer protection.

Note that insofar as Criminal Law is concerned, unlike a civil law action brought by a plaintiff, the action is brought by the Crown on behalf of 'the people' (not the police, as they enforce the law) against a 'person' for the commission of an act that the state considers to be a crime and that should be *punishable by a penalty* (for example, a fine or jail) if it can establish its case against the accused *beyond reasonable doubt*. Note that there is a higher degree of proof than is required in a civil case, where the plaintiff must only prove their case on the balance of probabilities.

In addition to the criminal sanctions that can be found in the criminal law legislation of PNG, an increasing amount of business-related legislation also carries what are known as civil penalties (also known as pecuniary penalties or fines) where there is a breach by a corporation (corporate crime) or an individual (if it is an employee, white-collar crime).

Civil penalties are reserved for conduct that falls short of criminal behaviour. The legislation provides for pecuniary penalties for conduct that falls short of criminal behaviour, but without the stigma attached to a criminal conviction, as (for the purposes of the law) an offence has not been committed.

Civil penalty proceedings generally require proof only to the standard of the balance of probabilities unless there are serious allegations of impropriety, in which case the court must be satisfied to a higher standard of proof. An example of where civil penalties can be found is the *Companies Act 1997* — Part XXII, s 413 where corporations, directors and managers may incur criminal or pecuniary (fine) penalties for breaches of the *Companies Act 1997*.


Online reference

The Companies Act 1997is a good example of an Act which can impose a civil penalty on a corporation or senior management for, in this case, a failure to comply with the *Companies Act 1997*.

Who is a 'person' in law?

All rules of law are concerned with the activities of persons. You will probably think of people or humans, but you would only be partly correct. For the purposes of the law, the reference to a 'person' includes not only human beings but also entities or organisations, which can have rights and obligations in much the same way as natural persons. Examples of entities include the Crown, companies and incorporated associations.

Revision questions

It's time for another break. Here are some more questions for you to consider. Remember to write down your thoughts for your notes.

A. Explain why an understanding of different legal systems around the world might be useful for you in business.

B. Why do you think it important to know what the term 'person' means in law?

C. Why is it important to understand the difference between international and domestic law in business?

D. Why do you think an understanding of the main principles underlying each

source of law is important when trying to understand how the law and business interact?

Part 5: What is PNGs political structure?

There are three tiers of government: national, provincial and local. If you wish to establish a business in PNG, you may need to consider the Acts, regulations and policies of all three levels of government, but note that finding up-to-date copies of legislation is time consuming and difficult.

The Doctrine of Separation of Powers

When PNG became independent it adopted a Westminster system of government as a constitutional democracy. Section 99 of the PNG Constitution provides for the separation of powers doctrine which provides for three arms of government, namely: the Executive (the Prime Minster and Cabinet), the Legislature (Parliament), and the Judiciary (the courts). Each arm has their own area of responsibility, and they keep a check on the actions of the others to prevent a concentration of power of any one branch, and to provide for checks and balances for effective and efficient government.

The separation of powers, together with the principle of 'responsible government', provide a guide for how laws are made and managed. Responsible government means that a party (or a coalition of parties) must have the support of a majority of members of the House to form a government (the Executive or Prime Minister and Cabinet). As noted in the last paragraph, this provides a check on the Executive and ensure accountability to Parliament. In addition, the Constitution vests the power of judicial review on the Supreme Court over both the legislation passed by Parliament and the actions of the Executive to ensure legislation passed by parliament, and the actions of the Executive government, comply with the Constitution.

National Government

PNG's National Government is a single or unicameral national parliament(there is no Upper House or Senate) that operates a multi-parliamentary democracy nationally. It has 118 members who are elected for 5 year terms, 96 of whom are from constituencies and 22 from single member provincial electorates (on election, each of the single members also becomes a governor of their province unless they become a Minister). It is a constitutional

monarchy with a Head of State (King Charles III), who is represented by a governor-general nominated by parliament who performs mainly ceremonial duties.

The PNG Constitution was adopted in 1975 and has been amended at least 43 times since then reflecting that it is essentially the product of a political process. Unlike western countries PNG has dozens of small political parties with no–one party getting enough votes to govern in its own right, which has resulted in a fluid party system and a lack of well-developed policy framework.

The Constitution and the Organic Law regulate the law–making powers of the National Parliament and can be found at Part VI of the Constitution and s 41 of the *Organic Law on Provincial Governments and Local-level Governments 2014*. While provincial and local or village governments have specific powers, they are subject to the national law but only to the extent that the national interest requires, otherwise they have relative autonomy.

Interestingly, as part of a constitutional review process the Constitution was reviewed by the Constitutional and Law Reform Commission (CLRC) in relation to its form and system of government. The CLRC report to the government was submitted in December 2023 but the report is still to be released and whether and what changes it might bring remains to be seen. Currently, the National Government is responsible for foreign investment, exchange control, immigration, trading and financial corporations, banking, most taxation, customs and excise, shipping and overseas trade.

Provincial Governments

There are 21 separate provinces and a National Capital District (which is similar to a provincial government) within PNG. Their powers are delegated to them by the National Government but note that as the powers of the Provincial governments are delegated to them, they are subordinate to the National Government.

Powers of the Provincial Governments include agriculture, fishing, trade and industry, land and land development, forestry and natural resources, rural health, transportation, village and urban or community courts (but not jurisdiction), commissions of inquiry, with limited revenue raising powers to impose sales and services tax.

Local and village Governments

Local and village governments are enshrined in the national Constitution and the Organic Law at Part VIA, s 187I of the Constitution while ss 26, 27, 28 and 44 of the *Organic Law on Provincial Governments and Local-level Governments 2014* and the *Local-Level Governments Administration Act 1997* provide the legal basis for the 336 local-level

governments (LLGs). The Minister of Provincial and Local Government Affairs is responsible for local government.

The powers of LLGs are subject to the national law and provincial governments, but only to the extent that the national or provincial interest so requires. A council will represent several villages and manage and administer the area that is under its control including labour and employment, provision of water and electricity, local trading and the local environment, some revenue-raising powers, and jointly with provincial governments, for health and environmental protection, waste disposal, roads and economic promotion.


Online reference

The Department of Provincial and Local-level Government Affairs provides a link between the National Government and the Provinces and LLGs.

Part 6: Do I need to know the National Constitution?

Hopefully you are now aware that the Constitution and the Organic Laws are the supreme law of PNG and that, subject to s 10 of the Constitution (construction of written laws), all Acts that are inconsistent with it are invalid to the extent of any inconsistency. You don't need to know the National Constitution of by heart, but it is useful to be aware of what it contains because it is the most important document in your legal system.


Online reference

Rather than try and give you a summary of the National Constitution, look it up online on the Papua New Guinea Consolidated Legislation webpage.

Reflection questions

Time to take a break from reading and think about the following questions:

A. What reasons can be put forward to explain why the PNG National Constitution has undergone change at least 43 times since its inception in 1975?

B. What do you think is the purpose of having a Constitution? Do we even need one?

C. Is the Constitution too complicated and should it be simplified? Explain why?

D. If you had the power, what would you change in the Constitution? Explain why?

Key points

An understanding of the following points, coupled with your answers to the Revision Questions, will help you to better revise material in this chapter and should form the basis for your notes. Don't try to memorise what you read but rather focus on understanding the material.

- **What is law?** There is no universally accepted agreement on 'what is law', but a starting point is that the law is a set of rules, developed over a long period of time, regulating people's interactions with one another.
- **What is Organic Law?** Organic Laws regulate the legislative powers of the National, Provincial and Local Governments of PNG and found in ss 41- 44 of the Constitution. The Constitution and the Organic Powers are the supreme law of PNG and *all* legislation that is inconsistent with the supreme law is invalid and void to the extent of any inconsistency.
- **What are rules, and what is law?** It does not automatically follow that rules are always law. To determine whether a rule is law, consider where it came from, how it deals with the person who has broken the rule, and the type of penalty that is handed

down.

- **What are the various classification of law?** Laws may be classified in a number of ways, including:
  - **the common law system** (based on precedent and statute law) and the civil law system (based on a code-based system)
  - **customary law**(laws that exist within tribal communities established through cultural or societal norms that existed before European occupation of PNG)
  - **international law** (which regulates conduct between states) and **municipal or domestic law** (a state's internal laws)
  - **public law** (concerned with the organisation of government and with the relationship that exists between people and the government—for example, constitutional law, industrial law, taxation)
  - **private law** (concerned with relations between natural and legal persons—for example, contract law, torts law, property law, company law); and
  - **substantive law** (actual rights and duties under the law) and **procedural law** (the rules of civil and criminal procedure, and evidence).
- **What is the distinction in common law between civil law and criminal law?** Civil law involves an action between individuals, where the plaintiff (who starts the action) has to establish, on the balance of probabilities, that their case is the more believable than that of the defendant and aims at compensating them. Criminal law involves an action brought by the state, with the state having to establish beyond reasonable doubt that the accused has committed a wrong for which they should be punished.
- **What are the major and minor sources of law that together make up the PNG legal system?** Three major types of laws are common law, equity and statute law, while minor types include customary law.

Chapter 2 references

Denning A (1955) *The road to justice*, Stevens & Sons Ltd, London.

PART II

PART 2. NEGLIGENCE

3.

THE TORT OF NEGLIGENCE

Learning objectives

On completion of this Chapter, you should be able to:

- Describe the tort of negligence
- List and explain the necessary elements required to establish negligence
- Identify the defences a defendant can raise in an action for negligence
- Identify and discuss the application of the tort of negligence to:
  - Occupier's liability
  - Strict liability
  - Vicarious liability
  - Product liability
  - Breach of statutory duty
  - The Rule in Rylands v Fletcher.

Watch this short video (4:07 minutes) which will give you a brief overview of "What is Negligence''? and will help you better understand the rest of the chapter.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://oercollective.caul.edu.au/intro-bus-law-png/?p=157#video-157-1

"What is Negligence''? video by Sharon Sanders, Centre of Teaching and Learning at Southern Cross University, licenced under CC BY-NC-SA 4.0

The transcript for this video is located under the Video transcripts and PDFs heading in the Back Matter of the book.

Key terms

Here are some terms you will encounter in this Chapter, which will help you understand the topic of negligence:

- **Contributory negligence:** negligence by the plaintiff that has contributed to their loss, damage or injury.
- **Negligence:** an indirect interference with the person or property of the plaintiff.
- **Negligent misstatement:** a false or inaccurate statement of fact made by a person recklessly or knowingly that there were no reasonable grounds for such a belief.
- **Occupier's liability:** as an occupier of premises, whether you own or rent, if you have control over the property, you must take reasonable care to ensure anyone who comes onto your premises is reasonably safe, although what is reasonable will vary according to the circumstances.
- **Product liability:** as far as manufacturers are concerned, at common law they owe a duty of care to consumers who purchase their goods and that the goods are fit for purpose. There is an overlap here with the *Goods Act 1951* and the Independent *Consumer and Competition Act 2002* which provide protection for the consumer.
- **Res ipsa loquitor ('the facts speak for themselves'):** a doctrine that provides that the elements of duty, breach and damage can sometimes be inferred from the nature of the accident even though the exact act of negligence cannot be exactly identified.
- **Strict liability:** liability regardless of fault where the defendant is held liable even though they were not at fault.
- **Tort:** a civil wrong other than a claim for a breach of contract.
- **Vicarious liability:** where a person is held responsible for the acts or omissions of another even though they may not have personally been at fault (for example, employer and employee).
- **Voluntary assumption of risk:** where the plaintiff freely and voluntarily understood and assumed the risk that caused the injury.

Introduction

Just note that when reading this chapter that you, the reader, will be treated as being the plaintiff unless otherwise stated.

Chapter 3 begins by considering what a tort is and the basis on which it operates; that is, through compensation for the injured party. It then looks at the function of the law of tort, the principles on which the law of tort rests, and the rights protected by the law of tort. The chapter then moves on to consider in more detail what is perhaps the most important area of tort law: negligence, and in particular how it relates to business, but also to you personally if you or your property is damaged by the actions of another party because of their carelessness (or negligence), for example, a car accident. This chapter then finishes by providing a brief overview of seven torts that have been absorbed into negligence including: vicarious liability; occupier's liability; product liability; negligent misstatements; strict liability; breach of statutory duty; and the rule in *Rylands v Fletcher*.

Part 1: Why is an understanding of the tort of negligence important?

The law of torts is an area of the law that can become relevant for you, and your business, often when you least expect it **but only after**a loss-making event has occurred. It is a legal wrong where one person or entity injures the person or property of another person and for which the usual remedy is an award of damages. For example, you go to the local shop to get milk and as you enter the shop you slip and fall on a wet floor where another customer had dropped a bottle of dishwashing detergent which the staff of the shop owner were still to clean-up. You break your hip. Can you get compensation?
This is the sort of scenario where a knowledge of the law of torts may come to your assistance. This is what we lawyers call a classic negligence action and it may enable you to recover compensation in the form of damages. Just as a matter of interest, who would you sue, if anyone? And if you were the shop owner, wouldn't this be a situation where it would have been a good idea to have liability insurance?

Video reference

For an interesting overview of Torts watch this video on Principles of Justice – Tort Law.

While not every event is foreseeable (or not far-fetched or fanciful), a lot of potential injury causing or loss-making events can be avoided by establishing good business practice. This means being proactive and taking the type of steps that a reasonable personin business might take if they were in a similar position and understanding what the legal consequences might be if such steps were not taken.

Business tip

Insurance pays

One of the features of tort law is that a person or business who is at fault should bear the consequences of their actions. In a negligence action this can be catastrophic for the wrongdoer, and beyond their ability to pay. The financial cost of a tort action is meant to deter others from intentionally causing harm. But the growth of liability insurance cover has largely negated this fear. Today, a potential wrongdoer knows that they can take out insurance cover against potential business risk. Any monetary loss or damage that a victim may suffer because of their actions will be borne by the insurance company rather than the business or individual.

What types of tort actions are there?

Just so you are aware, Tort law is not just about negligence (though you might think so). It is the most common of tort actions, other tort actions include:

- liability for a breach of duty to take reasonable care (**negligence**)
- liability arising out of occupation or possession of property (**occupier's liability** and part of negligence as well as **private nuisance**)
- direct interferences with the person, property or goods of another (**trespass**)
- liability for misrepresentations that affect a person's reputation and standing in the

community (**defamation**), or which cause financial loss (**negligent misrepresentation**)
- interference with contractual relationships (inducing **breach of contract, conspiracy or intimidation**)
- a fraudulent misrepresentation (if it doesn't form part of a contract, it may amount to the **tort of deceit**); and
- **breach of statutory duty** (involving motor traffic and work health and safety issues, and an action in its own right).

Part 2: What are the general principles of tortious liability?

The word 'tort' is a French word and it means 'civil wrong'. It is a type of behaviour by an individual (sometimes called a 'tortfeasor' but more often a 'defendant'), in the form of an act or omission not authorised by law that causes loss, damage or injury to another individual (such as yourself and who we call a plaintiff), their property, business or economic interests.

The law of torts is about the infringement of an individual's rights and the protection of those rights. If a person has suffered a loss or damage (which the law describes as 'harm') because of something that another person has done—or if they have suffered damage because of something that other person should have done but didn't—then the law of torts determines whether the injured person is entitled to seek a remedy for that loss or damage from the wrongdoer. That remedy is usually in the form of **compensation or monetary damages.**

Business tip

Do not assume that tort actions always result in the wrongdoer paying for the loss or damage suffered by you if you are the victim. In fact, before you commence a legal action it pays to do two things:

- first, find out whether you have suffered a 'harm' (or injury) that the law recognises
- second, can the defendant pay damages plus legal costs? Do they have

personal injury or professional indemnity insurance to cover the loss and legal costs? If they do not have insurance, do they have sufficient personal assets to cover your loss and legal costs?

If the defendant does not have either insurance cover or any assets, it may not be worth suing. But if you (as the plaintiff) decide that you still want to sue, and the matter goes to court and you win, can you recover damages from the defendant? The answer is: 'Probably nothing but your lawyers still expect to get paid'. You have to ask yourself whether it is worth the time and effort to sue. Just as the defendant must take you as the plaintiff as they find you, so must you take the defendant as you find them.

Win, lose or draw in court, the objectives of the law of torts are basically twofold:

- to protect the rights and interests of you if you are the victim by requiring the wrongdoer to rectify your loss or damage (**compensation**) and
- to impose a burden of rectification on the wrongdoer which will act as a **deterrent** to others who may want to act in a similar way

Just remember that **torts are breaches of the civil law**, not the criminal law and not to be confused with the civil law legal system found in Europe and other parts of the world. This means that if you are the plaintiff:

1. You commence the action
2. You have the onus of proof, **on the balance of probabilities**, that the loss or damage you suffered was caused by the actions/omissions of the defendant
3. You can show that you should be entitled to a remedy for the loss you have suffered.

What is the difference between law of torts and contract law?

In both tort and contract, the law is seeking to regulate a private relationship between two or more parties, with both (or all) aiming to provide remedies for the loss or damage suffered by the actions of the wrongdoer.

In **tort law**, any rights or obligations agreed between the parties are **imposed by law**, **not** as a result of agreement, and they can be **enforced only by an injured party**. In contract law, the rights or obligations between the parties are created through their agreement and

are **enforceable only by the parties to the contract** (and usually then only by the innocent party).

Damages in both tort and contract law cases generally restore the injured party back to the position they occupied (were in) before the tortious act or breach of contract occurred. So, if you are the injured party, how you decide to proceed will generally be influenced by the sort of outcome you may want.

In contract law, damages are awarded to place you in the position you would have occupied if the contract had been executed according to the agreement. A contract law action can also include claims for loss of expected profit and 'loss of expectation', which cannot be included in a tortious claim.

Sometimes the same set of facts can mean that you, as the injured party, may have a possible action in both tort and contract. For example, if a potential buyer of a business employs an accountant to advise on the financial viability of purchasing that business and they fail to do so with due care and diligence, actions may 'lie' in **both** contract and tort law. In contract, it is an implied term in the contract that the accountant will act with due care and diligence while in tort the action would be in negligence for breach of their duty of care.

It could be argued that in the contract action there is an 'implied' assumption (that is, one that is not expressed in the contract) that the accountant will exercise due care when examining the financial statements of the business. If the accountant can be shown to have failed in carrying out their implied duties appropriately, then the accountant has breached the contract with the potential purchaser.

The accountant may also have an obligation to the client in tort (in this type of situation, 'in negligence'). As we shall see later in this chapter when considering the tort of negligence, the starting point for such an action is the relationship between the parties and whether the accountant owes the potential purchaser a duty of care when it comes to carrying out their professional responsibilities. The question for the court to determine is whether a reasonable accountant in the same position would have discovered any anomalies in the financial statements.

However, having the two possible causes of action does not mean the injured party can recover damages under each action. Strategically, it gives the plaintiff a better chance of success because if one action fails, it may be possible to succeed under the other.

What is the difference between tort law and criminal law?

Both tort law and criminal law seek to impose duties on people, but they do it in different ways and with different outcomes. Yet interestingly, there is an overlap with the two areas

of law, for example, in the area of trespass to the person where there are three tort actions: assault, battery and false imprisonment, all of which are also potential criminal offences.

Tort law is private in nature in the sense it is brought by a person who has suffered some form of loss or damage and who is now seeking**compensation**from the person who caused that loss or damage. **Criminal law**, on the other hand, is **principally public in nature**, as breaches are enforced and 'prosecuted' by the state, and the outcome for the wrongdoer is **punishment**, generally imprisonment and/or a fine.

Criminal law and contract law distinguished from tort law

Legal Criterion	Criminal Law	Tort Law
The standard of proof	The Crown must prove its case beyond reasonable doubt	The plaintiff must prove their case on the balance of probabilities
Sanctions and remedies	The focus is on punishing offenders for their offence	The focus is on compensating victims
Consent	Whether the victim consents to the accused's actions is irrelevant	The injured party can consent to the defendant's actions
Role of the Crown	A convicted person can be pardoned	The Crown has no authority to pardon a tort short of legislating
Agreement	No agreement between the parties.	Tortious duty is imposed independently of the consent of the parties, although rights and duties may be varied contractually

Remedies

The most common 'remedy' in a tortaction is monetary compensation or damages.However, sometimes an injured party, such as yourself, may want some form of relief other than money. The relief you will be seeking will depend on the type of damage you have suffered. For example, if it is damage to your reputation, you may be seeking an injunction (a discretionary equitable remedy) to stop the offending party from causing further damage to your reputation; or you may seek an order of specific performance (also a discretionary equitable remedy) directing the other party to carry out their obligations. Both remedies are discretionary as the court is not obliged to award either of them, even if the plaintiff wins their case.

Although there may be remedies available to you as a plaintiff, there must be some reason for shifting the loss from you to the defendant. Sometimes this is not possible because:

- there may be statutory restrictions on what you as the plaintiff may recover (such as the civil liability legislation which excludes intentional conduct such as tobacco related claims)
- there may be no legal remedy because the harm may have been caused by accident or misjudgement
- the claim may be considered too trivial to warrant the attention of the courts
- there may be a complete defence available to the defendant: you knew what the risk was and went ahead regardless, and was injured as a result, for example in sport

Also, the fact that you as a plaintiff has suffered 'harm' recognised by the law and can shift the blame for their loss or injury on to the defendant does not automatically mean you will win your case. Whether you win or not may depend on a number of factors, including:

- the inability to find the tortfeasor
- the difficulty with proving fault on the part of a defendant
- whether the defendant is insolvent or uninsured (recovery of damages is difficult or impossible even if a tort is proved if the defendant has no money)
- whether you as the plaintiff has been partly or fully responsible for the damage they suffered—that is, contributory negligence or voluntary assumption of risk
- the cost of litigation (can you, as the plaintiff, afford the legal costs if you lose?)
- delay in obtaining compensation, placing pressure on you as the tort victim to settle the action before going to court, thereby increasing the chances of under-compensation
- difficulties in assessing accurately your actual loss—that is, assessing whether your injuries will worsen in the future.

What are the time periods for tort actions?

A criminal law action has no time limitswithin which an action can be brought by the State. In the case of a tort action, under s 16(1) the *Frauds and Limitations Act 1988* an action you must commence your action within 6 years from the date on which the cause of action accrued (if the action is against the State, then under the *Claims By and Against the State Act 1996* you have six months from when the claim arose) or the defendant may be able to argue that your action has become 'statute-barred' (that is, the plaintiff cannot proceed any further with their claim)

Reflection question

If you are injured because of the actions of another person, would your preference be to take action against the person who injured you in tort law or criminal law? Explain why.

Part 3: What is the tort of negligence?

Video reference

A simple introductory video titled Tort of Negligence: Standard of Care that will help you understand what negligence is.

As noted earlier, there is a wide range of torts, each covering a different type of 'civil wrong'. However, by far the most important tort is **negligence**. It is a tort capable of almost infinite expansion and adaptation, and its impact has been extensive on both business and the community.

In brief

A definition of negligence

Negligence is omitting to do something that a reasonable person would do, or doing something that a prudent and reasonable person would not do, to prevent harm. It is the failure to exercise reasonable care and skill that results in an unreasonable risk of foreseeable injury.

For most people, negligence generally means carelessness or thoughtlessness. However, this is not completely accurate. **Careless acts or misjudgements do not necessarily amount to negligence,and therefore do not necessarily lead to a court action in negligence**. As far as the law is concerned, a person is only liable for **harm**that is a foreseeable consequenceof the defendant's actions; that is, their failure to exercise reasonable care and skill which causes you injury, which carries legal consequences.

In an English House of Lords case called *Lochgelly Iron and Coal v McMullan* [1934] AC 1, Lord Wright described the concept of negligence in the following way:

> In strict legal analysis, negligence means more than needless or careless conduct, whether in omission or commission. It properly connotes the complex concept of duty, breach and damage thereby suffered by the person to whom the duty was owing.

The origins of negligence are based in the common law, with roots that go back to a case in Scotland in 1932 involving ginger beer and the remains of a snail in an opaquebottle – the House of Lords decision in *Donoghue v Stevenson*[1932] AC 562 marked the beginning of the modern law of negligence and laid the groundwork for business liability and today's consumer protection laws.

Video reference

Watch the short video above titled *The Decomposing Snail* and think about the following:

- who were the parties (the plaintiff and defendant)?
- Briefly summarise the facts

- What were the issues before the court?
- Briefly summarise the court's decision
- Just as a matter of interest, would you sue if you were in Donoghue's place?

Part 4: What are the roles of the plaintiff and the defendant in establishing the elements of negligence in PNG?

As the plaintiff, you can only commence legal action if you can first establish that yousuffered harm.'Harm' is broadly defined and includes death, personal injury, damage to property and economic loss.

What does the plaintiff have to establish?

If you suffer loss or damage (harm) that is recognised by the law as being of a type for which you should receive compensation (usually damages), then you must establish**(on the balance of probabilities) three(3) criteria** or your action fails:

- **Step 1:** As the plaintiff you **must** first establish that the defendant owes you a **duty of care** (here the focus is on the **foreseeability of causing harm to you as the plaintiff**). This is essentially a question of law that the judge decides based on common law principles.
- **Step 2:** If the defendant owes you, as the plaintiff, a duty of care, then you **must** establish that the defendant **breached that duty of care**? This step requires establishing what is 'a reasonable standard of care', a question of law.
- **Step 3:** If you can establish breach, then the final step you **must** establish as the plaintiff is that that the defendant's actions caused you, as the plaintiff, to suffer **loss or damage**? The loss or damage must be recognised by law and be factually caused by the defendant.

What is the 'reasonable person' standard?

To determine fault, the court examines the defendant's conduct and considers it against a standard of what a 'reasonable person' would or would not do in similar circumstances. The 'reasonable person' is someone of normal intelligence, credited with such perception of the surrounding circumstances and knowledge of other pertinent matters as a reasonable

person would possess in similar circumstances. For example, driving a car requires a certain set of demonstrable skills and knowledge. The same applies to professional standards and behaviour, such as expected knowledge, experience and skills. It is this requirement of reasonableness which has substantially contributed to the flexibility inherent in the negligence action. It permits social judgments by the courts relevant to the times to be made within the law-making process.

Once you, as the plaintiff, has established **all three elements** of duty, breach and damage, then the onus shifts to the defendant to present their case (although it should be noted that the defendant will have already argued that they do not owe you a duty of care; or if they do, then they haven't breached it; or if they have, you did not suffer damage as a result of their breach).

What does the defendant have to do?

- **Step 4**: Once you have established your case, **the onus shifts on to the defendant to establish a defence**—again, on the balance of probabilities this could be:c**ontributory negligence, voluntary assumption of risk, illegality or inevitable accident.**

Contributory negligence aside, if the defendant succeeds in establishing a defence, you as the plaintiff has lost your claim and the case ends at this point. If the defendant can establish contributory negligence on your part (that is, you failed to take reasonable care for your own safety), the court can reduce the amount in damages the defendant may have had to pay by an amount it considers fair and equitable, which can be up to 100 %!

- **Step 5**: If the defendant fails to establish a defence, or you contributed to your injury or loss, that only leaves the court to decide what sort of compensation or **damages** (usually monetary compensation) the plaintiff is entitled to

Online reference

At this point note that the PNG Magistrates' Manual – Chapter 15 contains an overview of key concepts in Tort (and contract).

Let's examine each of these steps in greater detail

It is important to note that each of the three elements, that is, duty of care, breach of that duty and damage suffered by you as the plaintiff, **must**be established by you.

Step 1: Does the defendant owe a duty of care to you – the plaintiff?

Video reference

This is quite a good explanation of the first step in deciding whether you have a cause of action in negligence. Watch this video titled Personal Injury: Experienced Attorney's Outline

A duty of care is the obligation owed by one person (the defendant) to another (the plaintiff) and is based on the relationship between them. It is perhaps the prerequisite of all negligence cases because it goes to the heart of liability by examining foreseeability of potential harm. It is the first question that a plaintiff must establish. In many cases you will find that the defendant does not argue this element because it is established from previous case decisions.

To establish a 'duty of care', you as the plaintiff must show that the kind of harm you suffered was reasonably foreseeable and was a result of the act/s or omission/s of the defendant. One way you can do this is by showing that you were one of the class of people who would foreseeably be at risk of injury if the defendant failed to take reasonable care.

The duty concept is a control mechanism and is a question of law (**not**fact, which is decided by a jury if there is one) **determined by a judge** who assesses the particular facts of each case. Note that duty will only be imposed when it is reasonable in all the circumstances to do so.

Depending on the facts, cases fall into two categories:

- those where duty is said to be established because the facts fall into a well-recognised duty category: for example, motorist–other road-users, employer–employee, manufacturer–consumer
- the 'novel' cases where the question of whether a duty of care exists is difficult to answer and depends on the surrounding facts: for example, in cases of economic loss, psychiatric illness and medical negligence

If you cannot show that the defendant owes you a duty of care, the action fails.

Is it safe to drink ginger beer in an opaque bottle?

The starting point for the **modern law of negligence** was the decision of the English House of Lords in a case called*Donoghue v Stevenson* (1932) AC 562.. It established a general test for when a defendant owes a duty of care to a plaintiff. Prior to this case, a buyer of a faulty good who suffered a financial or physical loss could only sue for a breach of contract.

Video reference

Watch this video on Donoghue v Stevenson, preferably while you drink a bottle of ginger beer in an opaque bottle with a friend to get really in the mood.

Think about the following while watching the video and drinking your ginger beer:

- who were the parties (the plaintiff and defendant)?
- Briefly summarise the facts
- State the issue before the court
- Briefly summarise the court's decision. Do you agree with it?

In a 3:2 decision, the House of Lords held that Donoghue was a 'neighbour' to the manufacturer and bottler of ginger beer (Stevenson), and the one to whom a duty of care was owed. But why? Stevenson should have reasonably foreseen that careless or negligent bottling could have harmed a consumer (not necessarily the purchaser).

In this case, Stevenson failed to ensure that consumers such as Donoghue could drink the contents free of impurities. As a result, she suffered shock from seeing the remains of a snail, part of which she had consumed, and suffered severe gastroenteritis from drinking the contaminated ginger beer. Next time you drink from an opaque bottle (or one where you can't see the contents), think of Donoghue v Stevenson and you can wonder what is in your drink here?

The court found that Stevenson (the manufacturer) had breached his duty of care to her by not making sure that his ginger beer was free from impurities. I**n this case, the foreseeability test works because the focus is on the prevention of harm to the plaintiff (consumer)**, But where the harm is caused indirectly, the question of reasonable foreseeability can be more difficult to determine.

Note that in *Donoghue*a breach of contract action **was not available** to the plaintiff as she didn't buy the drink, her friend did, and so she couldn't rely on the sale of goods legislation or sue in contract. Did you pick up this point when watching the video?

For a defendant to be liable in negligence they must owe you a **legal duty of care**. As noted earlier, this is a question of law for the judge to decide based on the factual merits of the individual case.

The duty of care concept says you must take reasonable care to avoid acts or omissions that you can **reasonably foresee**would likely injure your neighbour if you act, or fail to act, in a particular way without care as to what the outcome may be. This does not mean that a defendant owes a duty of care to ensure no harm befalls you. That would make the defendant an insurer. **The duty is one of taking reasonable care.**What the term 'reasonable care' means is constantly evolving and depends on individual circumstances.

In brief

The foreseeability test

Foreseeability is based on an objective test of whether a reasonable person would have foreseen that there was a real risk of the likelihood of injury to the plaintiff by taking into account all the circumstances of the particular case. But remember foreseeability alone does not give rise to a duty of care. While duty of care is one test of foreseeability, other important considerations can include:

- **reliance** of the plaintiff on the defendant
- **knowledge** on the part of the defendant about the risk
- the **vulnerability** of the plaintiff to harm from the conduct of the defendant
- whether the defendant has **the power** to control the actions of another and is in a position to stop the harm from occurring.

The question to consider in all negligence cases is whether there was a real possibility that the defendant's actions caused harm to the plaintiff. Were the actions of the defendant reasonable and it this requirement of reasonableness has substantially contributed to the flexibility found in a negligence action. It permits social judgments relevant to the times to be made by the courts within the law-making process.

It is worth noting that over the last three decades the Australian High Court has increasingly emphasised the importance of the autonomy and responsibility of you (if are the plaintiff) to take care of yourself, and this has been re-emphasised in Australian civil liability legislation and decisions of the courts. Do you think that is fair?

Again, whether a duty of care exists is a question of law—a question that **can be answered only by reference to the facts of each individual case, with a focus on the foreseeability of causing harm to you, the plaintiff.** This means considering all of the circumstances that may have a bearing on the relationship between the parties, including:

- the particular risk of injury that occurred
- the relationship of the defendant to that risk (that is, was the defendant in a controlling position through resources, knowledge or legal duty, and aware that they were in a controlling position?)
- whether the plaintiff was in a position of powerlessness and therefore reliant on the defendant
- whether the plaintiff's reliance put the defendant in a position that required them to be protective of the plaintiff
- the nature of the damage that the plaintiff suffered

In the majority of cases that come before the courts, whether the defendant owes you, as the plaintiff, a duty of care can be determined from precedents created by earlier cases from the UK and Australian courts. Examples of settled cases include the following:

- **Manufacturers** of goods owe a duty to consumers and users that the design, manufacture and packaging of products are not going to harm the ultimate user
- **Employers** owe a duty to employees to avoid causing them injury (providing the employee with a safe system of work, plant and equipment, and competent co-workers and supervisors: *Industrial Safety, Health and Welfare (Amendment) Act 2016*
- **Motorists** (and other road-users) owe a duty to passengers and other road-users including cyclists and pedestrians
- **Boat captains** owe a duty to their passengers
- **Teachers** owe a duty to their students
- **Councils** owe a duty to those who use their facilities
- **Occupiers** owe a duty to persons who come onto their property.
- **Professionals**, for example, lawyers, doctors, engineers, chemists owe a duty to their clients
- **Prison authorities** owe a duty to their prisoners
- **Lifesavers** owe a duty to swimmers who swim between the flags.

In brief

There is little difficulty in the 'settled' cases where physical injuries or damage to property have been caused by direct physical contact with you or your goods. You, as the **plaintiff**, **only needs to demonstrate that the injuries are reasonably foreseeable and** need to establish that:

- You are owed a duty of care; **and**
- The duty of care should be imposed in the circumstances

In addition to the established categories of duty of care outlined earlier, there are **several**

categories of immunity from liability, generally because of 'public policy', where the defendant cannot be sued including:

- the armed forces on active duty
- child protection agencies
- police officers, prosecutors and parole boards
- fire brigades and emergency services
- barristers
- statutory immunities under legislation

Is the duty question always clear cut?

Do not assume the duty question is always clear cut. Problems can arise in determining the duty in the following situations:

- **Where the harm is caused indirectly**. For example, in *Chapman v Hearse* (1961) HCA 46 (an Australian High Court decision), Chapman negligently caused a motor vehicle accident during which Dr Cherry went to assist. Dr Cherry was subsequently killed by another driver, Hearse. Hearse successfully brought action against Chapman for contribution for damages he was required to pay to Dr Cherry's estate.

The High Court held that Chapman owed a duty of care to Dr Cherry as it was reasonable to assume someone would come to Chapman's aid. There was therefore a relationship between Chapman and Dr Cherry, as well as a relationship between Dr Cherry and Hearse as a driver and road-user (person on the road). Both drivers owed Dr Cherry a duty of care, but they belonged to different, though still reasonably foreseeable, classes of person.

- In cases involving pure economic loss, such as *Hedley Byrne v Heller & Partners Ltd*(1964) AC 465, the English House of Lords recognised the pure economic loss suffered by the respondents (Hedley Byrne, an advertising agency).

Hedley Byrne were advertising agents. They placed contracts on behalf of a client on credit terms and would be personally liable should the client default. In order to protect themselves, Hedley Byrne asked their bankers to obtain a credit reference from Heller & Partners, the client's bankers. The reference was favourable, but also contained an exclusion clause to the effect that the information was given 'without responsibility on the part of this Bank or its officials'. Hedley Byrne relied upon this reference and subsequently suffered financial loss when the client went into liquidation. The court found that the banks disclaimer was sufficient to protect them from liability and Hedley Byrne's claim failed.

The significance of the case is that it established that financial loss suffered by a plaintiff for a negligent misrepresentation was recoverable. But not in this case. It is interesting to then note that this case is a good example of obiter dicta (sayings by the way) as the ratio of the case was that the exclusion clause was valid and binding. Also remember Donoghue was about a snail in a bottle and the duty of care of the manufacturer, so the decision in Hedley Byrne extended the rule relating to what negligence could apply to.

- In cases of **psychiatric injury (nervous shock)** and **mental harm**, the law has taken a restrictive approach to compensating people who have suffered no physical injury but have been left with psychiatric or mental problems as a consequence of the defendant's actions.

What about 'novel' cases?

In 'novel' cases, that is, where there have been no previous cases to guide the court, for example, climate change cases, once the court decides that the harm suffered by you was foreseeable the courts then look at what are referred to as the 'salient features (or factors)' of the relationship that exists between you as the plaintiff and the defendant.

Just for your information, the factors or 'salient features' that you could consider in a 'novel' case were set out in a list of 17 salient features by Allsop P in *Caltex Refineries (Qld) Pty Ltd v Stavar* (2009) NSWCA 258:

- the foreseeability of harm
- the nature of the harm alleged
- the degree and nature of control able to be exercised by the defendant to avoid harm
- the degree of vulnerability of the plaintiff to harm from the defendant's conduct, including the capacity and reasonable expectation of a plaintiff to take steps to protect itself
- the degree of reliance by the plaintiff upon the defendant
- any assumption of responsibility by the defendant
- the proximity or nearness in a physical, temporal or relational sense of the plaintiff to the defendant
- the existence or otherwise of a category of relationship between the defendant and the plaintiff or a person closely connected with the plaintiff
- the nature of the activity undertaken by the defendant
- the nature or the degree of the hazard or danger liable to be caused by the defendant's conduct or the activity or substance controlled by the defendant
- knowledge (either actual or constructive) by the defendant that the conduct will cause harm to the plaintiff

- any potential indeterminacy of liability
- the nature and consequences of any action that can be taken to avoid the harm to the plaintiff
- the extent of imposition on the autonomy or freedom of individuals, including the right to pursue one's own interests
- the existence of conflicting duties arising from other principles of law or statute
- consistency with the terms, scope and purpose of any statute relevant to the existence of a duty; **and**
- the desirability of, and in some circumstances, need for conformance and coherence in the structure and fabric of the common law.

Business tip

If there is knowledge of risk of injury, greater care should be taken

If a defendant has a greater than average experience of a particular risk, greater precautions may have to be taken than would normally be the case. Think about this in the context of medical procedures where there is always risk involved. Did the defendant act as a reasonably prudent person would have once it was determined that a risk of injury existed? Was the defendant's failure to eliminate the risk demonstrative of a lack of reasonable care for the plaintiff?

Note that if you are dealing with an infant, the standard to be applied is not the same as that of an adult but of a child of like age, intelligence and experience, thus requiring greater care needs to be taken by you if you are the defendant.

Should there be consideration of the particular risk of injury that occurred?

The question to consider here is: **What would be the response of a reasonable person foreseeing the risk?**The smaller the risk, the greater the likelihood a reasonable person would choose to ignore it. In formulating the duty of care, consideration must be given to the defendant's responsibilities and the resources available to them. **Remember that the law is not going to treat a defendant as an insurer of you (if you are the plaintiff).**

What is the relationship of the defendant to that risk?

This involves consideration of a number of factors, **including whether the defendant was in a controlling position through resources, knowledge, legal duty or right**.

Think about playing rugby. Does the League owe you a duty of care? There are a number of factors that need to be taken into account including your age when you were injured, whether the League arranged insurance for all its players and insisted they be registered with their clubs, that you were a player injured in a competition organised by the League, that the League tried to arrange for all coaches to be accredited but knew that some coaches had not undertaken coaching courses, that it knew that a number of under-age players played in and against open-age teams, and that it knew that some players were vulnerable to serious injury because of their physical characteristics, that players were not being taught how to tackle properly or made properly aware of the rules of the game.

What was the nature of the damage suffered by you?

In considering the nature of the damage suffered by you, the law does not provide compensation simply on the basis that the injury was disproportionately severe. Remember, it was noted at the outset that it is often a good starting point to look at the damage you suffered and see whether the damage is of a type that the courts are prepared to recognise as compensable or too trivial to amount to a cause of action.

It is also worth noting that in some cases—for example, in the case of an entrant who deliberately and for pleasure engages in hazardous recreational activities where the risks are obvious—the scope of the duty of care, and a breach of the duty, may be limited giventhe proposition that people ought to take reasonable care for their own safety. Do you agree?

Does liability follow an omission to act?

At common law there will generally be **no** breach of duty where physical harm or loss arises as a result of a **failure to act**, as the liability for an omission involves the imposition of a duty to take positive action. Thus, there is no duty to attempt a rescue, and this is so even if the defendant has the means available to affect a rescue. But note this rule is subject to a number of exceptions, usually arising from your reliance or dependence on the defendant where a duty of care may arise to take positive action; for example, a driver may be held liable for causing damage through failing to indicate that they were turning.

A positive duty of care may be imposed where the defendant is in a pre-existing 'protective' relationship with the plaintiff, such as parent and child.A child may sue

their parents, but parents are not automatically responsible for the torts of their children in the absence of 'special circumstances' such as personal fault.

In *Smith v Leurs* (1945) HCA 27 (an Australian High Court decision), the defendant's 13 year old son ignored the instructions of his parents not to fire his slingshot outside the boundaries of his home and hit another boy in the eye. The court found that while they were expected to maintain reasonable control over their children to avoid exposing others to unreasonable danger, the parents had done all that could be reasonably expected of them by telling their son not to fire his slingshot outside the boundaries of their property. Do you agree with that decision by the Australian High Court?

Again, note that the duty of care does not extend to that of an insurer.**It attaches only to where a person knows, or ought to know, by exercising reasonable care, of the existence of the danger.**For example, previous actions may create a reliance situation. But if the risk of injury is slight, then the precautions that need to be taken will be minimal.

Business tip

Once you start to do something, there is a duty on you to take reasonable care not to cause 'harm' to another, particularly if a situation has been created where the other party has come to rely on you and there is little effort or expenditure required.

Other common law examples of situations where liability for an omission has arisen and positive action by a defendant has been required include:

- Doctor/surgeon and patient: A doctor and a surgeon are under a duty to warn a patient of the inherent risks in proposed procedures.
- School authority and students: School authorities owe a personal, non-delegable duty to their students to ensure that reasonable care is taken while they are under the school's control. This duty arises out of the relationship of care and control that exists between students and teachers. But it will vary according to the nature and location of the activity, as well as whether the injury arises during school hours but note that the school is not an insurer and liable for every injury a child may incur while at school.
- Local councils: entrusted with statutory powers to protect public safety.
- Statutory authorities: in the exercise of their statutory powers.

Public authorities

There is not an absolute duty on a public authority (which includes the National Government, Provincial Parliaments, or local or village bodies or any public authority) to do,

or not do, a particular thing unless the act or omission of the authority was so unreasonable that no public authority with the same functions could properly consider the act or omission to be a reasonable exercise of its functions.

Recreational activities and the duty of care

Given that so many people participate in sport, and so many sporting activities involve some element of risk, it is worth considering what the duty of care is, if any, in recreational activities.

Negligence is still a fault-based system and, as a matter of law, there is a point at which those who indulge in pleasurable but risky pastimes must take personal responsibility for what they do. That point is reached when the risks are so well known and obvious that it can be reasonably assumed that the individuals concerned will take reasonable care for their own safety.

The scope of the duty of care may be limited where there is a high risk of being injured but as noted earlier, **whether a duty of care exists or not is a question of law.** It is a question that can be answered only by referenceto the facts of each individual case. That point will be reached when the risks are so well known and obvious that it can reasonably be assumed that the individuals concerned will take reasonable care for their own safety. This includes taking into account:

- consideration of the risk of the particular injury that occurred
- the relationship of the defendant to that risk; and
- the nature of the damage that you as the plaintiff suffered.

There are two questionsto consider here:

- **The factual question**: to what extent, if any, is the risk of serious injury from participation in the recreational activity obvious? Is there a hidden danger of which the parties should be aware? Was there signage that effectively communicated the risk.
- **The legal question:** this concerns the effect of the obviousness of the risk and the obligation to take reasonable steps to avoid foreseeable risk of injury.

The relevant question is whether the defendant, with their state of knowledge, acted as a reasonably prudent person should have done once it was determined that a risk of injury existed. ‘Did the defendant’s failure to eliminate this risk show a want of reasonable care for your safety? Note that the standard of care is lower for children because of their lack of understanding of what risk is.

A participant in a recreational activity not only owes a duty of care to other participants to operate within the rules, but they also have a duty to take reasonable care for their own safety where they are voluntarily participating in 'high-risk' recreational activities. Failure to exercise reasonable care may result in liability to an injured participant, while voluntary acceptance of the risk may act as a 'bar' to an action for damages.

Reflection question

Time for a break. Remember to try and revise regularly what you have read. So here is a problem question to think about while having a break. What are your thoughts on this fact scenario?

FACTS: Time to go swimming. The local resort has an excellent beach over which it had care, management and control. They employed lifeguards because of its popularity with tourists who often brought their kids down to the beach to play on the sand and swim. The lifeguards were responsible for making sure that the best places to swim were marked with flags and they encouraged people to swim between the flags for safety reasons.

You and some friends decide to do the right thing and swim between the flags but you didn't check the depth of the water and you were injured when you dived in and hit your head on a sandbar. The lifeguards on duty could see the sandbars and should have been aware that diving into the water without checking its depth was dangerous.

QUESTION: Did the resort owe a duty of care to users of the beach such as you to ensure that where the flags were placed was safe to swim? Did the lifeguards owe you a duty of care? Or was this a case of bad luck and you have no legal remedy?

WHAT IS YOUR DECISION? Do you think you have a case and could sue for damages?

HINT: Is it worth suing the lifeguards? Think about the question of duty of care in the context of the resort and what their responsibilities were to you and others, if any. Do you think that those who go to the beach, like yourself, have to accept a degree of responsibility for their conduct?

Step 2: Has the defendant breached their duty of care?

Video reference

This videoabout TortLaw from Cambridge Law Facility will provide you with a good overview of breach of duty of care and has some interesting examples that will help you understand breach.

Once you, as the plaintiff have established to the satisfaction of the court that the defendant owed you a duty of care (a question of law for the judge to decide), you then have to establish that the defendant has breached that duty of care. In other words, the defendant's acts or omissions failed to meet the standard of care required by the law, or as reasonably expected in the circumstance.

Whether there has been a breach of the duty of care involves:

- determining what is a reasonable standard of care as a question of law; and then
- determining whether the defendant has reached that standard.

What is the 'reasonable person'?

Video reference

This video titled 'what does it mean to be reasonable?' Explains quite succinctly what is the reasonable person and will help you understand what the expression means.

We have made a number of references to 'the reasonable person', and hopefully the video has helped you understand what this term means. A reasonable person is a hypothetical person created by the courts who is of normal intelligence, credited with such perception of the surrounding circumstances and such knowledge of other pertinent matters as an average person would possess.

If a person professes to have a particular skill—for example, driving a car—they are required to show the skill normally possessed by persons claiming such a skill. The law requires the person to show such (reasonable) skill as any ordinary member of the profession (for example, a doctor, a lawyer, an accountant or manager) or calling to which they belong would normally show.

It is worth noting again that this requirement of reasonableness has substantially contributed to the flexibility inherent in the negligence action. It permits social judgments relevant to the times to be made by the courts within the law-making process.

What standard of care is expected of the reasonable person?

The standard of care is the level (standard) that the defendant's conduct is measured against objectively. It is a **question of law**,not fact. The question to consider is: **What would the reasonable person have done if they had been in the defendant's position?**This means that it is generally not acceptable to argue that inexperience should be a valid excuse for failure to attain a standard of care that would ordinarily be expected of a person in that position.

Is the standard of care flexible?

The standard of care required in a particular case is a **question of law for the judge** to determine. It will vary from situation to situation, and is flexible depending on the circumstances of the case—for example, is it an emergency? —as well as the personal characteristics of the defendant, including age (young children are not expected to exercise the same degree of care as adults), fitness, health, disability, skill and knowledge.

For example, in an action in negligence where you are a passenger who has been injured in a motor vehicle driven by the defendant, the relationship of the parties is simply that of driver and passenger and normally the standard of care required is the degree of care of an experienced and competent driver, regardless of the driver's status.

It may also be necessary to consider the characteristics of the defendant in determining the standard of care such as the skill and knowledge of you (as the plaintiff), or whether you are still a child, intoxicated, a prisoner, or infirm or elderly.

What is the standard of care for children?

In the case of children, you need to understand that they are less capable than adults in taking care of themselves. So, the reasonable person test gives way a different standard, that is, the standard of a **child of similar age and experience.**

If you are placed in a position of responsibility for children, directly or indirectly, you must make the children's safety your foremost concern. This carries a more onerous duty of care because children don't perceive danger or risk in the same way you do as an adult. There is a duty of care placed on you but **your obligation is to exercise reasonable care,** not a duty to prevent conduct that could be potentially harmful.

What elements need to be established for breach?

If a duty of care is found to exist, you, as the plaintiff, mustthen establish that the defendant breached this duty.

- **there was foreseeable risk** (that is, a risk which the person knew or ought to have known based on what a 'reasonable person' would have known if they were in the position of the defendant); **and**
- what would a reasonable person in the same position as the defendant have done in the circumstances.

When trying to determine what precautions a reasonable person in the position of the defendant might have taken, the courtwill consider a number of factors, including:

- **The probability that the harm would have occurred if care had been taken.**This is to be **considered objectively**. In *Bolton v Stone*[1951] AC 850, an English case, the House of Lords found that the defendant may have been justified in disregarding a foreseeable risk of injury where there was only a remote chance of being hit by a cricket ball while walking past a fenced cricket ground, and one that a reasonable person would think highly unlikely to occur. A cricketer hit a six, which went more than 65 metres from the wicket, cleared a 2.2 metre fence and struck Stone, who was standing outside her house across the road from the ground. Not only was the probability of risk materialising quite low, but the precautions that the club would need to have taken to avoid a similar accident occurring could only have amounted to it ceasing to play cricket at the ground!
- **The likely seriousnessof the harm**.This is also to be **considered objectively**by reference to the particular circumstances of the case. If you are going to have an eye operation and the chances of going blind are 1:14,000, you should still be warned of

the risk because the outcome could be catastrophic even though the risk appears to be small. Why? Because this is what a reasonable person in the doctor's position would do?

- **The burden of taking precautions to avoid the risk of harm.** The magnitude of the risk and the probability of injury have to be balanced against the expense, difficulty and inconvenience of any action necessary to reduce the risk. Thus, if you are seriously injured when diving into an estuary from a bridge that had pictograms indicating 'No Diving' and signs prohibiting diving, the court will probably say 'No Diving' signs were a reasonable and adequate response and that the body responsible for bridge and road maintenance had not breached its duty of care given that there was a substantial cost for a new handrail and new fencing, and there was no guarantee it would have been effective.

The question to consider in trying to decide whether there is a breach is where the responses reasonable and adequate in the circumstances or were they impractical?

The court may look at the social utility of the activity that caused the harm as it might take the view that some activities are more worth taking risks for than others, such as playing contact sports like rugby league or union. Why, you may ask. Playing sports has benefits for the individual and for the community in terms of a healthier population. But contact sports like Rugby League and Union also carry a higher risk of injury to a participant than to someone who doesn't play sport. Therefore, the benefits have to be weighed against the costs and a decision made accordingly.

All the above factors do nothave to be satisfied in order to establish breach. What they provide is a framework for deciding what precautions the reasonable person would have taken to avoid harm

There is a rule of evidence that allows the plaintiff to treat the actual facts of the case as clear **evidence of the defendant's negligence**, that is, the facts speak for themselves. It allows negligence to be inferred if three conditions can be satisfied:

- the plaintiff's injury was one that **ordinarily would not happen** if proper care had been taken; and
- the plaintiff was injured by something within the **exclusive control** of the defendant; **and**
- there is an **absence of explanation** and no room for inference. It is worth noting that if the cause of the occurrence becomes known, the plaintiff has to then prove it was the defendant's negligence.

Two examples may help you understand how this principle works in practice. In the first

case (*Gee v Metropolitan Railway Co* (1873) LR 8 QB 161, an English case), the plaintiff fell out of the defendant's railway carriage shortly after the train left a station. As the railway was in control of making sure the carriage doors were shut, he succeeded against the railway company because there was no explanation other than that the railway company had been negligent because it failed to ensure the doors were properly shut.

In the second case (*Mummery v Irvings Pty Ltd* [1956] HCA 45, an Australian High Court case), the plaintiff failed because he was unable to show that the injury was directly caused by the negligence of the employee's foreman. The foreman was using a circular saw when a piece of wood he was cutting flew off and hit the plaintiff in the face. The plaintiff's case failed because there was no evidence to show that the occurrence was due to the negligence of the employer's foreman.

Business tip

Reducing the likelihood of injury

A business must take steps to reduce the reasonable likelihood of injury. The onus is on the you as the plaintiff to show that it was reasonably practicable for the defendant to take precautions against the risk. Once you have done so, the burden of proof switches to the defendant to establish that it was unreasonable in the circumstances to take such precautions. Risk management principles suggest that constant monitoring of:

- the probability of risk
- the seriousness of the consequences if something were to occur; and
- the opportunities for, and cost of, eliminating the risk are all serious concerns of a responsible business manager if liability of the business is to be minimised.

Reflection question

Time for another break. Here are three more questions to check your understanding of the topic.

1. What does the term 'reasonable person' mean to you?
2. What factors does a court take into account when judging the standard of care under common law.
3. Do you think children should be treated differently to adults? (Now this is an interesting question but can you see why? This question is really testing your reading ability.)

Step 3: Has the plaintiff suffered damage (a limiting factor)?

Causation

This is the last question that you, as the plaintiff, has to deal with in a negligence claim is the question of causation. **This is the bond between the defendant's behaviour and your injury. The issue of harm or damage is central to a negligence action.**

The onus of proof is still on you as the plaintiff and the good news is that this is the last step that has to be established by you in addition to duty and breach. The bad news…. a pity it is so complex.

There are two types of causation: factual causation and legal causation:

- **Factual causation** is also known as "but for" causation. This type of causation means that the result would not have happened if not for the act.
- **Legal causation**, on the other hand, requires that the act must be the proximate cause of the result, that is, the act must be the direct cause of the result without which the injury would not have happened.

Damage may be:

- economic (for example, lost or missed sales)
- to property (for example, damage caused by faulty plumbing or electrical wiring); or
- to the person (for example, a broken arm or leg as a result of a motor vehicle accident, psychological damage), as long as there is actual damage

Do not assume that any kind of damage is recoverable in a negligence action. **Only actual damage is compensable**, and this includes:

- damage to property or person
- economic or financial damage; and
- psychiatric damage (including 'nervous shock')

Don't assume that any kind of damage you suffer will automatically create a potential cause of action in negligence. Situations where you won't have a claim in negligence include damage from criminal or fraudulent activities (on policy grounds), where the form of damage is too vague (for example, expulsion from a social club, although the court will look closely at how the expulsion may have been carried out to see whether natural justice was followed), and even harm to reputation (where an action in defamation is appropriate).

In deciding liability for breach, you as the plaintiff **must** establish, on the balance of probabilities, that there is some **link** between the damage you suffered and the defendant's breach of their duty of care. In other words, y**ou have to show that the defendant's 'negligence was a necessary condition of the occurrence of your harm'** and is effectively a restatement of the common law 'but for' test; that is, would you as the plaintiff have suffered this damage 'but for' the defendant's negligence? The factual causation component.

If the injury would have occurred anyway, the action fails. In an English case called *Barnett v Chelsea and Kensington Hospital Management Committee* [1969] 1 QB 428 the plaintiff failed to establish causation. The hospital doctor refused to examine the patient who had attended an outpatient clinic after becoming ill from drinking tea containing arsenic. The doctor's failure to treat the patient was a clear breach of duty, but the man would have died anyway, even with medical treatment. The action of the plaintiff (the patient's wife) therefore failed because she could not establish the necessary causal link between the defendant's breach and the death of her husband.

In an Australian High Court case, *Strong v Woolworths Ltd* [2012] HCA 5, the High Court suggested that it was enough if the appellant (Strong) could prove, on the balance of probabilities, that the respondent's negligence was a necessary cause of his fall. In 'slip and fall' cases, a common problem is establishing a causal connection between the lack of an adequate cleaning system (an omission) and the injury to the plaintiff (an occurrence) when it cannot be established when the surface became slippery.

To establish proof of the causal link between the omission and the occurrence, it is necessary to consider the probable cause of events had the omission not occurred. For example, in Strong's case above, would she have fallen if Woolworths had

a system of inspection and removal in place at 15 to 20-minute intervals, as CPT Manager Limited did for the rest of the shopping centre?

The precise sequence of events does not have to be established by the plaintiff. The question was whether Woolworths' failure to adopt an adequate system of inspection and cleaning the cause of the appellant's injuries; that is, was the plaintiff (as this was an appeal, we use the expression 'appellant' rather than plaintiff as she is the person appealing and Woolworths is the 'respondent' because they are responding to the appeal) able to prove causation?

The High Court found that it was enough for the appellant to prove, on the balance of probabilities, that the respondent's negligence was a necessary condition of her harm. The chip was dropped between 8.00 am and 12.10 pm rather than the shorter period of time suggested by the Court of Appeal (between 12.10 pm and the time of the incident, which was not long enough for it to be detected and removed). The longer length of time opened the way for the court to find that the failure of Woolworths to adopt a reasonable system of cleaning was the effective cause of Strong's fall.

In another Australian High Court case, *Chappel v Hart* [1988] HCA 55, a surgeon negligently omitted to warn the respondent of a risk inherent in an operation on the throat of the patient and, while he performed the operation without negligence, the risk materialised. The respondent alleged that had she been warned she would not have had the operation at that time and she would have had a different surgeon perform it. The High Court held that the appellant's failing to warn of the risk, and not the actual operation, should be regarded as a cause of the injury when the risk eventuated.

Causation is determined subjectively—that is, what the injured person would have done, in the light of all relevant circumstances—as distinct from the objective test of the conduct of a reasonable person. However, any statement made by the person who has been injured about what they would have done is inadmissible, unless the statement is against the person's interest.

It should also be noted that in this case, while the 'but for' test was satisfied, other factors were required to be established before a majority of the court were satisfied that the surgeon should be liable in negligence. These factors included the timing of the operation (waiting for a more experienced surgeon), the plaintiff's concern over how she might sound after the operation (complications could occur without negligence and affect her voice), and the fact that she was an anxious and persistent patient who was concerned about the outcome of the operation.

In the case of **exceptional circumstances**, where a breach of duty is established but does not satisfy the requirement of 'factual causation', the court is required to consider,

among other relevant things, whether or not and why responsibility for the harm should be imposed on the defendant. And sometimes an intervening event involving the actions of a third person might relieve a negligent defendant of responsibility.

The second part to causation that you have to establish is **legal or proximate causation**. This is the legal principle that holds that a person who causes another person to suffer an injury or loss is legally responsible for that injury or loss. To establish legal causation, you are going to have to show that the person who caused the injury or loss did so through some act or omission that was negligent, reckless, or intentional. Were the defendant's actions the proximate cause of the injury or, to put it another way, would the injury not have occurred but for the defendant's actions?

Reflection question

Time for a break but before you stop, think about the following situation and you can find out what you have learnt so far.

THE FACTS: Imagine you are involved in a motor vehicle accident caused by the driver's negligence. At the hospital you are given painkillers to help manage the pain but they were not helping. A friend visits you at the hospital and you tell them the pain medication given by the hospital is not working. They suggest trying heroin and you agree and it works but you become addicted to it. You sue the driver for negligence, seeking damages for your injuries and for the heroin addiction

THE QUESTION: Is the negligent driver responsible for your addiction?

YOUR DECISION: Well, what is your decision and why?

HINT: Think about the conduct of the friend. Also think about whether responsibility for the heroin addiction should be imposed on the driver.

If there are a number of possible defendants and it is not possible to assign responsibility for causing harm to any one of them, the courts may assign responsibility under existing common law principles to all of the defendants, but in doing so it must consider the position of each defendant individually and state the reasons for bringing the defendant within the scope of liability.

You are going to have to show that the damage was a foreseeable consequence of the negligence of the defendant (similar considerations apply in the duty question), and whether the damage suffered fell within the scope of foreseeability or was too 'remote'.

What has to be foreseeable is the type or kind of injury suffered, one that a reasonable person would describe as 'real' rather than 'far-fetched' and requires a value judgment about the allocation of responsibility for harm.

The 'egg-shell skull' rule

One final point. The 'egg-shell skull' rule provides that a defendant must take you, as the plaintiff, as they found you. This means that a defendant will be liable for injuries suffered by you despite the fact that you have had a pre-existing condition, such as a medical condition, which resulted in the injuries being significantly greater than might otherwise have been the case.

This rule applies only to damage of the same kindas that which was reasonably foreseeable. The doctrine is applied in all areas of torts (as well as in criminal law).

Reflection question

Think about what you have read about causation.

1. Can you explain the purpose of causation in relation to the liability of a defendant
2. Having established duty, breach and damage, do you think the defendant should be liable for all the damage have suffered?

Step 4: What defences might a defendant raise?

This is a question really about the consequences for the defendant if they fail to convince the court that they did not owe you a duty of care, or that they had not breached that duty, or that they were not responsible for the harm or damage that you suffered. The onus now shifts on to the defendant to establish any defences to reduce or eliminate their liability.

The two most common defences under the common law are contributory negligence (see also ss 40, 41 of the *Wrongs (Miscellaneous Provisions) Act 1975* and voluntary assumption of risk. Both defences involve consideration of all of the surrounding circumstances, including the behaviour of you, as the plaintiff, and the issue of personal responsibility.

Online reference

Find online the link to the *Wrongs (Miscellaneous Provisions) Act 1975*.

Contributory negligence

Contributory negligence is about apportionment of blameand you as the plaintiff assuming some responsibility for your injuries or damage to your property. It needs to be distinguished from voluntary assumption of risk which, if successful, may defeat your claim in its entirety, depending on the circumstances; for example, that you failed to take reasonable care for your own safety because you were drunk or under the influence of drugs at the time of the accident.

The principles that are applicable in determining whether a person has been negligent also apply in determining whether the person who has suffered harm has been contributorily negligent—although it should be noted that it is not necessary that you as the plaintiff owe the defendant a duty of care.

Essentially, the court looks at whether you failed to take reasonable care for your own safety, with the standard of care being assessed on the basis of the reasonable person and what they would have, or should have, known in the circumstances. This is consistent with the courts taking the view that people need to take responsibility for themselves and then considering whether you had fallen below that standard. **Contributory negligence must be pleaded and proved by the defendant**.

To establish contributory negligence, the defendant mustbe able to establish that:

- **you, as the plaintiff, was at fault or negligent in failing to look after yourself;** a question of fact judged in light of all the circumstances

- **your conduct contributed to the injury or loss**—this means looking at what was the cause of the damage (but remember that each case must be judged on its own set of facts and circumstances, such as intoxication, emergency or anticipation of a breach by others); **and**
- **the damage was reasonably foreseeable and was contributed to you by your actions (or lack of them)**:a question of fact.

The standard of care is based on a reasonable person in your standing in place of you, and the matter will be decided on the basis of what the person knew or ought to have known at the time. If you were an infant, the standard of care would be that an infant.

In all jurisdictions there is a **presumption of contributory negligence** if the person who suffers harm was drunk or if the person who suffers injury was relying on the care and skill of a person, they knew to be drunk. In the case of intoxication, it is presumed that it impacted on your ability or capacity to exercise reasonable care for your own safety at the time of the breach. You will then attempt to rebut that presumption by arguing that you were not intoxicated and that if you were, it did not impair your capacity to exercise reasonable care for your own safety.

Apportionment of damages is based on what is fair and reasonable ('just and equitable') between the parties however, as noted earlier, contributory negligence may defeat a claim. Part IX of the *Wrongs (Miscellaneous Provisions)Act 1975*, s 40 provides that a plaintiff such as yourself is entitled to recover a portion of the damages based on the negligence of the defendant.

Online reference

Apportionment of liability where contributory negligence is raised by a defendant is set out in Part IX, ss 38-40 of the *Wrongs (Miscellaneous Provisions) Act 1975*.

Voluntary assumption of the risk

Voluntary assumption of risk is a complete defence. It is very difficult for a defendant to successfully raise as a defence because it has to be established that you knew there was a

risk of injury **and** knowingly engaged in the activity which resulted in your injury, that is, you had consented to the full risk of injury.

A defendant can minimise their exposure to risk in one of two ways:

- **expressly**, by signing an agreement in which you acknowledge the risk of injury and agree to accept or assume the risk. This is usually in the form of a written waiver or exclusion clause. By signing a liability waiver or a contract that contains an exclusion clause, you agree to accept the risk but as you will see when we look at contract law, waivers and exclusion clauses are construed strictly against the party relying on them;**or**
- **by your conduct**where you knowingly and voluntarily engage in a risky or dangerous activity. You have impliedly assumed and assented to acceptance of the risk. Examples could include going rock climbing or water skiing with friends, or attending a sporting event such as football or cricket and getting hit by the ball. In each case there is always a risk of injury and the defendant would argue that a reasonable person would be aware of that risk.

Step 5: What may a plaintiff recover?

Generally, in a negligence action, you as the plaintiff, will be seeking monetary compensationfor the damage or loss you have suffered. This could be a physical injury to you or property damage, economic or financial damage, or psychiatric damage but just note that damages are awarded on a case–by–case basis. It should also be noted that the purpose of a damages award is compensation; that is, to put you in the position you would have been in had the tort not been committed.**Do not confuse damage, which is about loss, with damages, which is about compensation.**

Where **two or more**persons have caused injury to you, the requirement that there be proof of negligence of one of them can create difficulties, unless they were **joint tortfeasors**

Part 5: Other areas where the tort of negligence has an impact

Just when you thought this was the end of negligence it is worth remembering that at the beginning of the chapter we noted that there were other areas of tort law that had been subsumed by negligence. There is not enough time now to explore them in any detail but an awareness of each can still be a valuable tool in both personal and business disputes.

The seven areas are: vicarious liability, occupier's liability, product liability, negligent misstatements, strict liability, the rule in Rylands v Fletcher and breach of statutory duty.

Vicarious Liability

Employers can be held variously liable for the acts or omissions of their employees who cause injury or property damage to a third party. In PNG, vicarious liabilityis governed by common law principles.

The employer is not personally at fault but is held to be responsible for the actions of an employee where the **employee is under the control of the employer by way of a contract of service.** If the employee is an independent contractor, vicarious liability as an action is not available as the employer has limited control over a contractor and acting in the course of their employment. The independent contractor is said to be acting under a**contract for services.**

Members of the community often ask why is an employer liable for the acts or omissions of their employees when they have done nothing wrong? An employer can only be liable for the wrongful acts or omissions of an employee that are undertaken in the scope or course of employment, and the relevant act need not be authorised.

Vicarious liability may arise in relation to an employee's unauthorised acts that are "so connected" with authorised acts that they may be regarded as modes, although improper modes, of doing the authorised acts. The reason for the employer being held liable for the actions of the employee is that the employer benefits from the activities of the employee (called a 'profit') and if the employee should injure a third party during the course of making a profit for the employer, it is only fair that the employer should be prepared to compensate the injured third party.

A point to note here is there is little benefit of an injured third party suing an employee as they would rarely have the money to pay damages. On the other hand, the employer is much more likely to be able to pay damages, either through the costs of the business or public liability insurance.

Reflection question

Take a break and read the following scenario. Who would you sue and why?

FACTS: Deatons operates a hotel. You were a customer at the hotel and after a few beers you acted offensively towards one of the hotel's employees, a barmaid. She asks you to sober up and go away. An argument developed and the barmaid threw a glass of beer over you, and then through the empty glass into your face.

HINT: What is a barmaid employed to do? Were her actions within the course of her employment?

Occupier's Liability

Occupier's liability has been absorbed into negligence. You owe anyone who enters your premises, including guests, those who enter by express or implied permission—such as visitors and salespeople—and even those who are uninvited, such as trespassers a duty of care. It means that if you are an occupier, and this could be an owner or a tenant, you must take reasonable care of anyone who comes onto your premises that it is reasonably safe to do so, although what is reasonable will vary according to the circumstances.

Online reference

See ss 52-54 of the *Wrongs Miscellaneous Provisions Act 1975* and Part 15.7.1 – Occupiers liability, of the Magistrates Manual.

Under the *Wrongs Miscellaneous Provisions Act 1975*, s 52(1) a 'common duty of care' applies to all visitors unless the occupier expressly restricts or excludes their duty. Because of the control an occupier has over their premises it is important to understand the extent of the occupier's ordinary duty under s 52.

To establish occupier's liability, you as a plaintiff must establish the defendant had occupation or control of the land or structure (that is, own it, be a landlord or a tenant) and then:

- Would a reasonable person in your position as the defendant have foreseen that the conduct involved a real risk of injury to the plaintiff? **and**
- What would a reasonable person do in response to the risk? This could be any number of factors including the magnitude of the risk, the cost of removal of the risk, its degree of probability, whether the risk is ordinary, and whether it is obvious.

If you are a landlord, note that s 54 of the *Wrongs Miscellaneous Provisions Act 1975* sets out a landlord's obligations in relation to the maintenance or repair of their premises.

Do not assume that you must remove all hazards on the property you control as it is not strict liability. What it is about is taking reasonable care to avoid exposing people to unreasonable risk of injury.

Reflection question

Read the following scenario and think about the issue of occupier's liability and why it is important

FACTS: The plaintiff, a 53-year-old mother of three children, suffered an injury when she tripped and fell on the uneven surface of your driveway of your house while attending a garage sale. The driveway had a very uneven surface with a number of pot holes and was atypical of houses in the area. The mother had stated that at the time of her injury, she had been looking towards the goods on a table at the garage sale, and that she had not been paying attention to where she was walking.

QUESTION: Do you owe the mother a duty of care?

WHAT IS YOUR DECISION? Are you liable for the mother's injuries?

HINT: Was the risk obvious? Should warnings have been given or the table put in a different location? Would you answer be the same if the sale had been a commercial venture at a market?

Product Liability

The decision of the English House of Lords in *Donoghue v Stevenson*[1932] AC 562

(discussed earlier) established that manufacturers owe a duty to the consumer (which could be you next time you get a ginger beer in an opaque bottle) to take reasonable care when:

- a product is sold, that it reaches you as ultimate consumer in the form in which it left the manufacturer
- there is no reasonable possibility of intermediate examination by you; and
- it is reasonably foreseeable that, in the absence of reasonable care by the manufacturer, you will be injured.

If a product is negligently manufactured, assuming it is locally manufactured, that company or business is responsible for how the product is made. As *Donoghue v Stevenson* illustrates, the manufacturer owes a duty of care to the consumer to take reasonable care as absence of reasonable care in the manufacture of the product can result in injury to the consumer's life or property (you), and liability common law liability for the manufacturer in negligence. If the manufacturer is in another country then a whole host of problems arise, not the least of which are whether it is even possible to sue them and the cost of litigation.

In fact, a problem with trying to sue a manufacturer, or a wholesaler or retailer, is money. A legal action in negligence can be both costly and complicated when compared with litigation under the *Goods Act 1951*, the *Independent Consumer and Competition Act 2002*and the *Fair Transactions Act 1973* which provide statutory protection for you as the consumer.

Reflection question

Read the following fact scenario and think about your legal position if you were the consumer.

FACTS: You have purchased a new outfit to wear for a job interview direct from the manufacturer (OnLine Clothing). You have not had time to wash it before the interview because you were worried it would not be dry in time for the interview. The garment contained chemicals that, it was found, had been left in them due to the lack of care of the manufacturer. When you complained to the retailer who sold you the outfit they said 'Not our problem' Tell the manufacturer. The manufacturer then produced evidence that it had

manufactured nearly 10,000 similar outfits for PNG and Australian customers without a complaint and argued that no one could say that it was not a reasonably careful manufacturer.

QUESTION: Does the manufacturer owe you a duty of care?

WHAT IS YOUR DECISION?

HINT: Is this just a tort action? It is important to always think about what other legal options that might be available to you?

Strict liability

To win a strict liability (or absolute liability) case you must be injured and be able to prove that the defendant's product or actions caused the injury**regardless ofcarelessness or fault regardless their intent or mental state**, that is, a duty ensure reasonable care is taken.

A defendant can be held liable for damages or losses without the plaintiff having to prove intent or negligence. Strict liability or non-delegable situations typically arise out of employer-employee relationships where there is an obligation on the employer to provide a safe place of work, a safe system of work, competent staff and proper plant and equipment. Aside from these obligations there are also duties imposed on employers by statute such as the *Occupational Safety, Health and Welfare Act 1991* and the *Workers Compensation Act 1978.*

The employer can delegate their responsibility but cannot avoid their duty even if they delegate performance to a third party. An example of strict liability where the court found against employer is *Edwards v Jordan Lighting and Dowsett Engineering (New Guinea) Pty Ltd* [1978] PNGLR 273 the plaintiff was inspecting some light fittings when the ladder slipped and he fell injuring himself after the second employee let it go. The court held that both the employer and second employee were liable for damages as the second employee failed to warn the plaintiff in advance he was letting go of the ladder and the employer was liable for failing to provide a safe system of work.

In addition to strict liability has been applied to activities including holding an employer strictly liable for torts committed by their employees, the principle of strict liability has been applied to product liability, damage caused by animals (distinguish between domestic and wild animals. In the case of the former, the keeper is only liable if they had actual knowledge

of the animal's propensity to cause harm while in the latter case the keeper of the animal are strictly liable because they are known to be dangerous), and common hazardous activities such as storing explosives.

Breach of statutory duty

A person who suffers damage from a breach of a statutory duty by a defendant**may**have an action for breach of a statutory duty. In a claim for a breach of statutory duty it has to be established that the defendant, whether a public authority or a private body, was under a statutory duty to do something and did not, resulting in a breach of duty and damage to the claimant.

A starting point for breach of a statutory duty is to read the legislation carefully to see whether the statute expressly provides for a right of action for breach of its terms, in which case the calculation of damages will be calculated in accordance with the Act. In most cases however, a statute is silent on whether contravention will be actionable or not. In this situation, the courts have to 'discover' the intention of Parliament by applying rules of statutory interpretation.

The rule in *Rylands v Fletcher*

While the rule in *Rylands v Fletcher* (1868) UKHL 1 has been absorbed into negligence in Australia and some other common law jurisdictions, it still applies in PNG. It is a tort of strict liability and a cause of action can arise if an occupier of land (the defendant) accumulates or brings on to their land something which could be 'dangerous' if it escapes in the course of some 'non-natural' use of their land to a place outside their occupation or control, they must keep it in at their peril, and if they don't, are strictly liable for all the damage which is deemed to be reasonably foreseeable.

The claimant must be able to establish that:

- that the defendant brought something onto their land
- that what the defendant made a 'non-natural use' of the land
- that what the defendant brought onto the land was likely to do mischief if it escaped; and
- that there was an escape which caused damage of a reasonably foreseeable kind.

There are a number of defences available to a defendant including consent, statutory authority, act of God, act of a stranger, and the fault of the claimant.

Reflection question

The last reflection question. If you are the claimant do you think you could win the case and why?

Facts: you owned and operated a mine adjacent to the defendant's property. The defendant employed some independent contractors to construct a reservoir on his land. During the construction of the reservoir the contractors found a number of disused sunken mine shafts which, unknown to the defendant, they decided to leave as they appeared to be filled up with soil and rubbish. When the defendant's reservoir was filled for the first time it burst through the old shafts and flooded your mine and caused several thousand dollars damage.

Question: What legal options, if any, are available to you?

Decision: Explain your decision.

Key points

An understanding of the following points will help you to better revise material in this chapter.

- **What is the nature of a tort?**A tort is a civil wrong other than a claim for breach of contract and for which a right of civil action fordamages may arise.
- **What is the difference between tort and crime, and tort and contract?** The main difference between a tortious action and a criminal prosecution is one of purpose:
  - In tort, the partiesare concerned with the resolution of a private dispute that may result in the award of some appropriate remedy, whereas in criminal proceedings the prosecutor is a representative of the public andconcerned with punishment and the repression of crime; while
  - Contract law is concerned with the enforcement of promises, and compensation if there is a breach of contract. Tort, on the other hand, is concerned with the

protection of rights.

- **What is negligence?**Negligence is the omission to do something that a reasonable person would do, or doing something that a prudent and reasonable person would not do. It is the failure to exercise reasonable care and skill.
- **What are matters of fact and matters of law?** Matters of fact include:
  - Resolving conflicts in evidence
  - Evaluating the conduct of the parties
  - Whether the defendant caused the damages, and what was its extent
    - Matters of law include:
    - All questions of duty
    - The standard of care
    - Questions of remoteness
- **What are the elements necessary to establish negligence?**The injured partymust establish, on the balance of probabilities, that:
  - the defendant owed them a duty of care
  - the defendant breached that duty of care to them; and
  - as a consequence, the plaintiff suffered actual loss or damage recognised by the law
- **Under what circumstances does a defendant owe duty of care to the plaintiff at common law?** The duty question is a question of law and has to be established to the satisfaction of the judge. The approach to the question of the existence of a duty of care today is determined by application of the 'foreseeability' test and includes consideration of whether there was a vulnerable or dependency relationship between the defendant and the plaintiff, as well as policy considerations.
  This is the duty owed by a defendant to a plaintiff and is based on the relationship between them; that is, to take reasonable care to guard against the foreseeable risk of injury to another. Duty of care is not just restricted to the question of negligence but other areas of tort as well such as vicarious liability, occupier's liability, strict liability, negligent misstatements, Rylands v Fletcher, and product liability.
- **What is a breach of duty of care?** Having established the existence of a duty of care, the plaintiff must then show, on the balance of probabilities, that the defendant was at fault. Determining whether there has been a breach of the duty of care involves a two-stage test:
  - The first stage is to determine whether or not the risk was reasonably foreseeable. A person is not negligent in failing to take precautions against a risk of harm unless there was foreseeable risk, the risk was not insignificant and, in the circumstances, a reasonable person in the position of the defendant would have taken precautions.
  - In the second stage, the court should consider the following factors: probability that the harm would have occurred if care had been taken, the likely seriousness

of the harm (to be considered objectively by reference to the particular circumstances of the case), the burden of taking precautions to avoid the risk of harm, and the social utility of the activity that caused the harm.

- **What is the concept of standard of care?** The defendant's conduct is judged against an objective standard and is determined by the court measuring that conduct against the standard of care. The onus is on the plaintiff to show that the defendant's conduct fell short of the standard of care that a reasonable person in the defendant's position would have taken in response to the circumstances at the time in response to a reasonably foreseeable and not insignificant risk.
- **What is the importance of causation?** In deciding liability for breach, the plaintiff must establish on the balance of probabilities that the defendant's conduct caused the plaintiff's personal injury. Damage may be economic, to property or to the person, but there must be actual damage, and this raises two more questions for the plaintiff to prove:
  - Was the loss or damage to the plaintiff 'directly caused' by the defendant's breach of their duty of care (causation)? This is a question of fact and determined by weighing up the evidence through applying, as a general rule, the statutory 'but for' test. Where a breach of duty is established but does not satisfy the requirement of 'factual causation', the court is required to consider, among other relevant things, whether or not and why responsibility for the harm should be imposed on the defendant.
  - If the plaintiff can prove that the defendant's conduct was a necessary condition of the injury that they have suffered, is it appropriate for the scope of the negligent person's liability to extend to the harm so caused (scope of liability)?
- **What defences can a defendant raise to a negligence claim?** Under the common law, the two main defences which may be pleaded by a defendant) are:
  - **contributory negligence**, which can be up to 100 per cent and thus effectively defeat the plaintiff's claim for damages (but note the operation of the *Wrongs Miscellaneous Provisions Act 1975*); and
  - **voluntary assumption of risk**, which would defeat the claim for damages, is a risk that in the circumstances would have been obvious to a reasonable person in the position of the plaintiff and would not be taken by them.
- **Reasonable person** – a hypothetical person who exercises what is considered to be the average care, skill and judgment that a reasonable person in the community or similar area of expertise would exercise.

References

Sanders A (2024) "What is Negligence"?, *Centre of Teaching and Learning at Southern Cross University*, licenced under CC BY-NC-SA 4.0

PART III

PART 3. CONTRACT LAW

4.

INTRODUCTION TO CONTRACT LAW

Learning objectives

On completion of this Chapter, you should be able to:

- describe what is a contract and its sources
- recognise the sources of contract law, and distinguish between a contract and an agreement
- define a contract and identify the essential elements of a contract
- explain the difference between a formal contract and a simple contract.

Key terms

Here are some terms you will encounter in the text, which will help you further understand this chapter:

- **Acceptance:** an unqualified assent given in response to an offer, which creates an agreement.
- **Agreement:** one of the requirements for the creation of a contract, normally consisting of an ‘offer’ and an ‘acceptance’, which may arise expressly or be inferred from conduct, between two or more people.
- **Contract:** an agreement containing promises made between two or more parties, with the intention of creating certain rights and obligations, which is enforceable in a court of law.
- **Escrow:** an assurance in the form of a deed, money or bond held by a third party on behalf of two transacting parties that the transaction can be completed.
- **Formal contract** or **deed:** a contract that has been signed, sealed and delivered, and does not require consideration.
- **Simple contract:** a contract that is made orally or in writing (or both) involving an agreement between parties with the intention of creating legally enforceable

obligations and which requires consideration to be valid.

Introduction

This chapter introduces you to what the sources of contract law are, what a contract is, its creation and classification and concludes with a brief note on e-commerce. Chapters 4 – 12 introduce you to what is perhaps the most important area of law you will encounter in business or your daily life. Contracts play a crucial role in business and society. Without them, life as we know it could not exist. Contracts underpin all transactions involving businesses, as well most transactions that you enter into as a consumer. An understanding of contract law will help you understand not only how and when a contract has been created, but also what are the rights and obligations of you and the other party to the contract.

However, there are three things you need to be aware of before we begin:

1. First, the contracting parties owe each other a duty of good faith, not just when entering into a contract but then when both parties are carrying out their contractual duties. PNG courts have legislative powers to review contracts that are unfair under (see s 1(a)) of the *Fairness of Transactions Act 1993*. But it should also be noted that although the duty of good faith exists in PNG contract law, it is still developing, so always be on guard when entering into a contract that you understand exactly what you are getting to (see s 4(1) of the Fairness of Transactions Act 1993). It will be one of the smartest things you will ever do).
2. Secondly, if you have to prepare a contract, always try and write it in 'plain English', that is, keep it simple. If I have to write a contract, I always get someone to check it to try and ensure that it makes sense and that there are no errors. The reason is that what you write and what you see are sometimes different.
3. Final point, like Chapter 3 on negligence, this and subsequent chapters are all written with you standing in the shoes of the plaintiff. Why you ask? Because in real life, in the examples given in these chapters, you could be the injured party.

Why is it important to have an understanding of contract law?

Contract law plays an important role in business and society generally, and an understanding of contract law can be a very useful tool to have a basic knowledge of.

Contracts, along with negligence, are a fundamental part of everyone's daily life. They form the basis of the daily business and consumer transactions that you enter into. Without enforceable contracts, society as we know it could not exist. Voluntary agreements are all very well but remember that agreements can *never* become binding without a legal contract.

A contract brings a degree of certainty for both businesses and consumers that the parties will fulfil the obligations that they have agreed to because of its legal enforceability in a court of law. As you will see, voluntary agreements are not legally enforceable.

What are the sources of contract law?

PNG contract law is primarily derived from three sources:

- common law (case law)
- equity (case law)
- statute law.

Much of contract law, and the right of freedom to contract, that applies in PNG is based in common law principles that were developed in the English, Australian and New Zealand common law courts – that is, case law decisions. You will often find both English and Australian cases still being cited as authority for a contractual principle even today and you will find little statute law.

Equitable principles are, like common law, derived from case law, and have also played an important role in contract law. For example, in the case of formation of a contract, two areas where the courts have applied equitable or statutory principles are in the areas of:

- promissory/equitable estoppel, which allows a promise to be enforced even if there is no consideration (as you see when we look at consideration, this is normally an essential element in every simple contract)
- unconscionable contracts, where one party has taken unfair advantage of the other (note the purpose of the *Fairness of Transactions Act 1993*).

Online reference

If you have a chance, have a look at the *Fairness of Transactions Act 1993*. Its purpose is mainly to ensure overall fairness in any transaction.

What is the difference between a contract and an agreement?

To a layperson, the terms 'contract' and 'agreement' are often used to mean one and the same thing. In fact, one of the traditional definitions of a contract is that it is a *legally enforceable agreement*. But while contracts involve an element of agreement, do not assume that every agreement is going to turn into a legally binding contract.

Business tip

Be aware, an agreement is not necessarily a contract.

As just noted, while every contract involves an element of agreement, do not assume that every agreement will result in a legal contract, because:

- the parties may not intend to create legal relations (for example, many public competitions state that a contract is not intended, and going out with a friend on a social occasion is certainly not intended to create a contract); **and/or**
- one or more of the principles governing contractual relations may not have been satisfied (for example, the purpose of the agreement may be illegal or there is a lack of consideration).

Sometimes a contract exists irrespective of the wishes of the parties. An example is your compulsory third-party insurance through Motor Vehicles Insurance Ltd (MVIL) as part of the registration of your vehicle. This can hardly be seen as an 'agreement' because neither you nor MVIL has any choice about either the contents of the contract, or even about whether you wish to make a contract for compulsory third-party insurance coverage.

What is a contract?

To have any legal significance, the agreement must contain a promise, be supported by consideration *and* have been intended by the parties to be legally enforceablein a court of law. It is the performance of this promise and its legal consequences which are fundamental to modern society and which form the basis of the study of contract law.

The person who makes the promise is called the promisor, and the person to whom the promise is made is the promisee. Think about it. You make promises every day: to meet someone, to go to the movies, to lend money, to obey certain rules and so on. However, remember that not all of these 'promises' are intended to create legal relationships, for example, agreeing to meet someone or going to the movies. If you don't turn up, do you expect to be sued?
What distinguishes contractual from non-contractual promises is the consequences of failure to perform.A promisor who fails to perform a non-contractual promise has no legal liability.For example, if you arrange to meet a friend at the movies and your friend does not turn up, are you going to sue them? The failure to turn up is not considered to have very serious consequences by the courts (other than to the friendship!).
If the promise is contractual, such as a promise by a repair person to fix your laptop and when you pay them it still doesn't work, then you (as the promisee) are generally entitled to treat the repairer's promise (as the promisor's promise) as non-performance and a breach of contract. You can seek a remedy, usually damages, through the courts.

How is an 'apparent' simple contract created?

The term 'simple contract' refers to the manner of its formation, *not* the nature of its terms or that it is 'simple' to create. The creation of a simple contract (note that at this stage there is no question of whether the contract is valid or enforceable), requires the presence of three elements (or three steps if you like):

- **Step 1:** was there an agreementbetween the parties? There must be an offer by one party, and an acceptanceor some evidence of a final agreement by the other (see chapter 5 on agreement).

If you think there is an agreement, go to:

- **Step 2:** was there an intention to contract? The parties must intend that their promises create legally enforceable obligations (see chapter 6).

If you think there is an agreement and intention to contract, go to:

- **Step 3:** was there valuable consideration? There must be something of value or benefit passing from one party to another in return for a promise to do something, unless the promise is made under seal or in the form of a deed (see chapter 6).

Once you have established that each of these elements is present, an apparent simple contractcan be said to exist. But at this point you do not know whether it is valid, and therefore enforceable. So don't stop checking yet.

Is the contract enforceable?

If you are satisfied that there is an agreement and that you and the other party intend to create a contract supported by consideration (if you are entering into a deed, consideration is not required), then you have successfully created a simple contract, but is it valid and enforceable?

There are now three more steps you need to take before you can start to feel confident that what you have created is a valid and enforceable contract, not an unenforceable one:

- **Step 4:** do the parties have legal capacity? Did both of the parties understand what they were doing? What if one or both of the parties had limited capacity, for example, were underage (that is, under 18), or under the influence of alcohol or drugs (see chapter 7 on 'Capacity')?
- **Step 5:** is there genuine consent? What did the parties' consent to or, was there a mistake, a misrepresentation, duress undue influence or unconscionable conduct which could mean the contract may fail (see Chapter 8 on 'Consent')?
- **Step 6:** was there legality of purpose and in the proper form? The purpose of the contract must be *legal*, not*illegal*.
- **Step 7:** was there any particular formthe contract needed to be in (that is, could the contract be oral, or did a statute require it to be in writing)? Are there any statutory requirements that must be satisfied? (see Chapter 9 on 'Legality' and 'Form').

As you will discover, how these questions are answered will help determine whether or not the contract is enforceable in court should a dispute arise between you and the other party.

How are contracts classified?

Contracts may be classified in a variety of ways, including formation, enforcement, performance and discharge. Knowledge of how contracts are classified will help you understand what type of contract you are dealing with, what is required of you and the other party, and the enforceability of the contract.

What are bilateral and unilateral contracts?

Contracts are either bilateral or unilateral, depending on what *the offeree* (the person to whom the offer is made)must do to accept *the offeror's* (the person making the offer)conditions of agreement. Most contracts are simple and bilateral.

Note the difference between a bilateral and a unilateral contract. The parties have different obligations under a unilateral contract compared with a bilateral contract. This is why you need to understand whether the language of the offer is creating a unilateral or a bilateral contract.

- **Bilateral contract:** A bilateral contract involves a promise for a promise. It isthe most encountered form of contract because it is created every time someone buys goods or services. Both parties have obligations.As a buyer, you have an obligation to pay for the goods or services, and the seller has an obligation to provide them.
- **Unilateral contract:** A unilateral contract is where only one party assumes an obligation. There is no contract until the offeree performs the requested act, as they have the option of choosing whether or not to perform. It is a 'promise for an act'.

An example of a unilateral contract involves reward cases where you lose something and offer a reward to anyone who finds it. There is no obligation on anyone to go and look for the item. But if someone is aware of the reward and they find the lost item and return it to you, then there is an obligation on your part to pay the reward if the finder makes a claim for it. If the offeree abandons their effort halfway through, they would not be in breach of contract. Nor would they be entitled to payment for their efforts because they have not complied with the conditions for payment of the reward (that is, they have not found the lost item).

Problems can arise if you, as the offeror of a unilateral contract, attempt to revoke an offer *after*the offeree has begun performance. While there are no problems if you withdraw the offer before the offeree begins performance, there may be difficulties where the offeree has begun or substantially completed performance. As you will see in Section 4 of this chapter, part-performance of the act called for may be regarded as sufficient consideration for you as the offeror not to be able to revoke your promise.

What does classification according to enforceability mean?

As you read on, you will discover that there are references by the courts to the contract being 'valid', 'voidable', 'void', 'unenforceable' or 'illegal'. It is important to understand the meaning and effect of each of these words on a contract because they are words used by the courts to describe the enforceability of the contract between the parties.

- **Valid:** a valid contract is one that the law will allow either party to enforce.The parties intend to enter into a legal relationship and have agreed on the terms, thus creating legal rights and obligations, which the parties can enforce against each other in court.
- **Voidable:** the contract remains valid and binding unless and until it is *rescinded* or *terminated* (ended) by the innocent party. The difference between recission and termination is important when looking at remedies, as we shall see in the chapter 'Rights and liabilities of the parties, discharge and remedies', as they create different outcomes in relation to damages. Whether a contract is void or voidable can be particularly important where an innocent third party is involved. If the contract is voidable (that is, it is valid and binding unless and until repudiated by the injured party), the seller of an item may not be able to recover the item from a third or subsequent party in possession of it if the item was obtained fraudulently.
- **Void:** a person who enters into a void agreement cannot enforce it or be forced to comply with it because there are *no legal rights* or obligations to enforce or comply with from the beginning of the transaction. Nor could they pass on good title to a third party because they would have no title to give. For example, if you have your computer stolen by another person and they sell it to a third party, the contract between the thief and the third party is void or of no legal effect. The thief has no title to give to the third party. If third party subsequently sells the computer to a fourth person then that person gets the same title to the computer that the third party had – that is, no title. You could then force the fourth party to give back the computer or its value. Why? Because the fourth party has no title and they would have to seek compensation from the third party, and they would have to try to find the thief (good luck there) to get back the value of the computer.
- **Unenforceable:** while the contract appears to be valid,no legal action can be brought on it. This can happen because some procedural requirement is lacking – for example, a statute requires the contract to be evidenced in writing – for example, contracts for the sale of land. Correction of the defect will generally render the contract enforceable. This raises the issue of form (see below).
- **Illegal:** when the purpose of the contract contravenes a statute or the common law, it will be illegal and generally treated as being void –for example, something of a criminal nature, such as robbing a bank with a friend.

What is classification according to performance?

- **Executed contracts:** an executed contract is performed and completed at the time of making. For example, if I wash your car for K25 and you pay me as soon as I finish, the agreement has been fulfilled and the contract expires.
- **Executory contracts:** an executory contract arises when one of the parties promises to do, or refrain from doing,something in the future. For example, I agree to wash your

car next week for K25. Here, both promises are yet to be performed.

What is classification according to formation?

- **Express contracts:** these are contracts where all the terms are agreed on by the parties and they may be:
  - wholly in writing (if the contract is important to you, have it put in writing as evidence of what you have agreed to)
  - evidenced in writing
  - oral
  - partly written and partly oral.
- **Implied contracts:** the contract is implied from the circumstances surrounding the acts or conduct of the parties. For example, if you catch a taxi, it is implied that you will pay the fare and the driver will get you (safely) to your destination.
- **Quasi-contracts:** The contract is the result of an 'agreement' imposed by law, such as third-party car insurance and is imposed irrespective of whether there is agreement between the parties.

Is the contract a formal or simple contract?

Contracts may be classified into formal and simple contracts. Here the question is about the way in which the contract is made (its 'form')and not about its content(its terms). Of the two, the simple contract is the one most often encountered in commercial and day-to-day transactions, but it is still important to understand the difference between formal and simple contracts because of the consequences that may follow if the wrong choice is made – that is, the enforceability of the contract.

- **Formal contracts:** these are contracts that must comply with certain execution formalities usually imposed by statute, that is, be in writing and signed. They get their validity from their form alone.

Note that the *Electronic Transactions Act 2021* has impacted on the statutory requirements requiring certain contracts to be in writing and signed as set out in the *Frauds and Limitations Act 1988* and the*Copyright and Neighbouring Rights Act 2000* by providing that the *Electronic Transactions Act 2021* will apply, with some exceptions, to any kind of transaction whether it be commercial, non-commercial, domestic or international.

- **Deeds (contracts under seal):** these are promises that *must* be in writing on paper, parchment or vellum, *and* signed by the party or parties to the contract *and* delivered. There is no need for consideration. They are often used in a company arrangement (a

binding arrangement between a company and its creditors as to how the company's affairs will be handled). A deed that is delivered subject to conditions and does not come into operation until the fulfilment of these conditions is called an escrow.

- **Simple contracts:** this is a contract that is neither a formal contract or a deed, so to be enforceable, it musthave valuable consideration present for it to be valid.

Subject to statutory requirements, simple contracts can be created expressly, impliedly or by quasi-contract. By way of an example, a receipt from the supermarket for groceries or a service station for fuel which contains on its face the date and time of purchase, the items and the price, as well as the total price paid by the purchaser is evidence of acceptance of the items and would be more than enough to establish a contract.

Business tip

If the contract is important, put it in writing

As noted above, if the contract is important, put it in writing and have both parties sign it at the bottom of the last page, as well as signing or initialling the bottom of each page. This is because written evidence provides greater certainty as to what the parties agreed to than is the case with verbal contracts, where much of the evidence will be based on the recollections of the parties. Verbal contracts can lead to expensive litigation as the parties argue over what they really agreed to.

If the parties have taken the time to reduce the agreement to writing, the courts will assume that it is a complete record of the contract. Hence the need to be careful when drawing up a contract because the courts are generally reluctant to admit evidence of acts or words of the parties before the execution of the document if this has the effect of adding to, varying or contradicting the written agreement. This is known as the *parol evidence rule*(see the chapter 6 'Construction of the contract').

When are contracts void unless in writing?

Certain simple contracts, to be valid and enforceable, are required by statute to be wholly in writing. If they are not, they are void. Note that the *Electronic Transactions Act 2021* now satisfies the statutory requirement of 'in writing' if the document is in electronic format.

What contracts must be evidenced in writing?

There is a second class of contracts that statutes require to be evidenced in writing. The absence of writing does not affect their validity, but it makes them *unenforceable* in a court of law.

The Sale of goods of K20 or more

Section 6 of the *Goods Act 1951*requires contracts for the sale of goods costing K20 or more to have *one* of the following three requirements, or they will be unenforceable:

- the buyer has accepted part of the goods sold and actually received the same; **or**
- the buyer has given something in earnest to bind the contract or has given something in part-payment to bind the contract; **or**
- some note or memorandum in writing of the contract is made and signed by the party to be charged or by their authorised agent—for example, an auctioneer is the agent of the seller and, after the sale, also an agent of the buyer.

What is a note or memorandum?

A note or memorandum can take any documentary form—a letter, docket, invoice or even an entry in an auctioneer's book—and it does not even have to be contained in one document, but it must show *all* of the following (s 6(1)):

- the names of the parties
- the subject matter
- the consideration; **and**
- the signature of the party to be proceeded against or the party's authorised agent.

What is e–Commerce?

E-commerce is about individuals and businesses buying and selling goods and services online, that is, over the internet. You can participate in e-commerce anywhere you can find an internet connection. In PNG the formation of the e-contract is regulated under the *Electronic Transactions Act 2021* and, it provides that the law must treat electronic and paper-based contracts, in terms of formation, equally.

It should be noted that the legal framework required to govern e-commerce in PNG for products and services is a work-in-progress with the National Government yet to develop

a comprehensive e-commerce policy notwithstanding that e-commerce now makes up a significant proportion of the PNG market.

Reflection questions

It is the end of the chapter so a good time for a break. Here are some revision questions for you to think about as well as a problem question while having a break. Write down your thoughts as they form part of your notes.

A. What elements are necessary for the creation of a valid simple contract?

B. Explain the difference between a formal and a simple contract.

C. Explain what sort of problems may arise in contract law for users of e-commerce?

D. Explain whether an unaddressed proposal in an electronic communication to create a contract is an invitation to make an offer or is it an offer that others can accept?

PROBLEM: You have decided to buy some land to build a house on. You made an offer on some land owned by Kone. An initial text from the defendant's agent advised you that the vendors would accept K410,000 on a 30-day settlement. It identified the land and the essential terms of the bargain. You confirmed acceptance of the terms and asked Kone to advise on the procedures for the contract and payment of the deposit.

The agreement was not made subject to the signing of a contract and it was anticipated that you would pay a deposit forthwith and sign a contract in accordance with the terms of the agreement. On the same day, Kone's agent sent you a text which contained several attachments, which you downloaded, signed and scanned and returned to the Kone's agent.

Kone subsequently refused to sign the contract. One of his arguments was that as the contract was for the sale and purchase of land, PNG law provided that no action could be brought on any contract for the sale unless an agreement or some memorandum or note of it was in writing and signed by Kone or his authorised agent.

QUESTION: Is there a contract?

WHAT IS YOUR DECISION?

HINT: Do you think that an exchange of texts was sufficient to constitute a note or

memorandum? Remember that the memorandum or note does not need to be contained in one document; it can be made up of several documents that can be connected.

Key points

To help you have a better understanding of Chapter 4, here is a list of Key Points on some introductory matters with respect to contracts.

- **What is the difference between a contract and an agreement?** A contract is a written or oral agreement containing promises made between two or more parties that create rights and obligations enforceable in a court of law. An agreement, while similar to a contract, is not legally binding and enforceable because it lacks one or more of the essential prerequisites that must be present for a legally enforceable contract.
- **What is the definition of a contract?** A contract is an agreement containing promises made between two or more parties that create rights and obligations that are enforceable in a court of law.
- What are the elements of a simple contract? Intention to create legal relations, agreement and consideration must be present to create a simple contract. There is no question of validity.
- **What is required for a simple contract to be valid?** Legal capacity, genuine consent, legality of objects, and compliance with form will determine whether the simple contract is not valid or enforceable.
- **What is the difference between formal and simple contracts?** A formal contract is signed, sealed and delivered, and derives its validity from its form alone (it does not need consideration). A simple contract requires the presence of all 6 elements (including consideration) and compliance with any statutory requirements (form), and may be oral, written, or partly oral and partly written.

5.

AGREEMENT: OFFER AND ACCEPTANCE

Learning objectives

On completion of this Chapter, you should be able to:

- Explain why it is important to establish at the outset whether the parties have reached an agreement
- Explain what an agreement is
- List and explain the rules relating to an offer
- List and explain the rules relating to acceptance
- Explain the operation of the postal rule
- Explain the rules relating to e-commerce.

Key terms

Here are some terms you will encounter in this Chapter, which will help you to better understand this chapter:

- **Acceptance:** an unqualified assent given in response to an offer, which creates an agreement.
- **Agreement:** one of the requirements for the creation of a contract, normally consisting of an ‘offer’ and an ‘acceptance’, which may arise expressly or be inferred from conduct, between two or more people.
- **Contract:** an agreement containing promises made between two or more parties, with the intention of creating certain rights and obligations, which is enforceable in a court of law.
- **Counter-offer:** an offer made in response to an offer which implies rejection and terminates the original offer.
- **e-contract:** a contract created electronically in the course of e-commerce, generally by email or SMS.

- **Formal contract or deed:** a contract that has been signed, sealed and delivered, and does not require consideration.
- **Objective test:** a test that asks whether the words or conduct of the parties would lead a reasonable person to believe, on the balance of probabilities, that legal relations were intended – that is, whether they intended to create a contract.
- **Offer:** a communication amounting to a promise to do (or not do) something.
- **Offeree:** the one to whom an offer is made.
- **Offeror:** the one who makes the offer.
- **Promisee:** the person who is receiving, or the recipient of, the promise.
- **Promisor:** the person undertaking the promise.
- **Simple contract:** a contract that is made orally or in writing (or both) involving an agreement between parties with the intention of creating legally enforceable obligations and which requires consideration to be valid.
- **Rejection:** occurs where the party to whom the offer was made (the offeree) tells the party making the offer (the offeror) that they are not accepting the offer, which terminates it.
- **Revocation:** occurs where the offeror withdraws an offer, which then terminates it.
- **Termination:** bringing the contract to an end before it is fully performed.

Introduction

In this chapter we are going to begin by looking at what the law requires to be established for the creation of a simple contract: the agreement. The agreement is based on two elements: offer and acceptance and each must meet certain criteria if there is to be an agreement. Unless the parties agree, a contract cannot come into existence.

Step 1: Agreement between the parties

To find out whether there is a simple contract look at the facts to see whether you can identify whether there has been an offer by one party and an acceptanceby the other to form an agreement. If there is an agreement, that will form the basis for a simple contract.Or to put it another way, no agreement, no contract.

What constitutes a contractual agreement?

The agreement goes to the heart of a contract because, **unless the parties agree, a contract cannot come into existence**.

So, what is an agreement? It is the culmination of a negotiating process between the parties. Today, negotiations are often done electronically with the exchange of internet files and the use of electronic communication tools such as Skype, Zoom, Team and other voice-over IP programs.

But just note that it is not the negotiating process that creates legal rights and obligations but, rather, the end of that process—the contract of which the agreement is a part (the other parts being intention and consideration).

To determine whether an agreement exists, a traditional starting pointhas been to consider three components:

- there is a minimum of two parties (but note that there can be more than two parties, which is known as a multipartite agreement)
- there is an offer; **and**
- there is an acceptance.

But that is not the end of the story because in addition to the three components mentioned above there must be:

- **an exact correlation between the two sides of the agreement**—what is known as a *consensus ad idem*—that is, the parties must have exactly the same thing in mind
- **an offer** by one party **(offeror)** to be bound on certain terms; and

- **an unqualified acceptance** (not limited or restricted in any way) to that offer communicated by the other party **(offeree)** to the offeror

Business tip

If the parties haven't reached an agreement, that is the end of the story. Where the

parties do appear to have reached an agreement, the following considerations should still be noted:

- Generally, only what is agreed between the parties during the offer and acceptance stages can become part of the contract. Terms the parties have not agreed on or have forgotten to include in the contract are not considered part of the contract. Such terms may require a new contract or result in expensive litigation to try to determine what it was that the parties agreed to.
- Changes cannot be made unilaterally – that is, by one party. Variations, alterations or additions must be agreed to by **both** parties.
- The terms and conditions that make up the agreement create legally enforceable rights and obligations, and if they are not carried out—that is, they are broken—then the matter may finish up in court.

Is there agreement between the parties? How do you determine an agreement?

Traditionally, the courts have said that an agreement is reached when the conduct of the parties can be characterised in terms of an 'offer' by one party (offeror) and an 'acceptance' by another (offeree). This technique is certainly important in determining the time, place and content of the agreement, and it is a useful tool in most cases, but it is not the only available means of contract formation because there are cases where it is not easy to locate an offer or acceptance.

The courts have not abandoned the traditional approach of using offer and acceptance to determine agreement. It is just that in some cases the traditional approach is not helpful in determining whether the parties have reached an agreement. As McHugh AJA, in the Australian case of *Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd (1988) 5 BPR11 at 110*, suggested that 'contracts may be inferred from the acts and conduct of parties as well as or in the absence of their words'. The question is whether the facts, when viewed as a whole and objectively considering the surrounding circumstances, show that, from the point of view of reasonable persons on both sides, a concluded agreement has been reached. That may not be easy, particularly if the contracting parties have used qualifying words in their agreement such as 'the purchaser *intends*to acquire…' or 'the proposedagreement will provide that …'. The words in italics would suggest that an agreement had not been reached if you think about the meaning of those words.

If the parties have not reached agreement on terms that they regard as essential for a

binding agreement, there can be no binding agreement. But this doesn't consider the extent to which the courts are prepared to go to hold that a contract exists in a commercial transaction, if the essential or critical terms have been agreed on. Even a series of emails may be enough to create a contract.

How do the courts approach commercial or business transactions?

In the case of commercial transactions, the courts will try to ensure that the expressed arrangements and expectations of the parties are carried out where they are satisfied that the parties have reached agreement. This is judged by objective standards, notwithstanding that the communications between the parties might have been uncertain and particular terms had still to be worked out. But in the great majority of cases the traditional approach of offer and acceptance will still suffice.

As far as agreement is concerned, note the following:

- Agreement is the result of negotiations by **two or more** persons of the substance of a contract. **It may not necessarily be the contract**.
- It is unusual for the parties to have discussed and agreed to every term of the agreement. In some cases, if the negotiations have been going on for some time, this may be true. However, in many commercial transactions there will only be broad agreement on the substance of the contract, with the details to be worked out later. **It is the act of assent which gives rise to the agreement.**
- In business today, many agreements are entered into based on standard form documentation. This consists of a set of pre-written, standard, non-negotiable provisions in the agreement between the parties and are commonly found in business transactions where there is high-volume distribution of goods and services between sellers and consumers – for example, consumer credit and insurance contracts, eBay user agreements and airline conditions of carriage. These type of 'standard form' agreements are usually drawn up in advance by the person putting the agreement forward (usually the party with the most bargaining power), with the other party offered the terms on a 'take it or leave it' basis. If there is an inequality in the bargaining power between the parties and this raises the question of not only ascertaining whether 'agreement' has been reached but, in some business transactions, whose terms will prevail.
- The term 'agreement' assumes that the parties are in an equal bargaining position. However, the reality is that **in many consumer and commercial transactions, the inequality of bargaining power means that many contracts are not arrived at by 'real' agreement.** The weaker party, who is often a consumer, either accepts the

terms or goes without. It is only then where the pressure used by the stronger party is unconscionable that the courts may be prepared to set aside the contract (see Chapter 11, 'Terms of the contract').

- Even if the agreement is considered to be non-contractual, it may still result in a statutory breach of, for example, the *Fairness of Transaction Act 1993.*

Business tip

Agreement does not have to go into detail, if it can be said that a reasonable person would believe that an offer had been made and was accepted by the other party.

Can you have an agreement arising from conduct?

While offer and acceptance are, as a general rule, clearly expressed in an agreement, it is still possible for an agreement to arise by way of implication as a result of the conduct of the parties. For example, at a yacht club regatta, you and all the other competitors had to sign an undertaking to be bound by the club rules as a condition of participation, but not with each other. One the rules provided that a competitor should pay all damages if they injured another competitor or their boat. Here, while there was no clear offer and acceptance, the effect of entering the regatta and undertaking to be bound by a common set of rules, suggests acceptance on your part to create a contractual obligation as a condition of entry.

Mere participation will generally not on its own provide the basis of a contract between participants and organisers. But in the example of you entering the regatta above, there is evidence of intention to enter into a contract from the conduct of the parties. **Signing the undertaking meant you accepted that you would be bound by the rules as a condition of participation—a multipartite transaction.** The court looks at the conduct of the parties and the documents that governed entry into the competition.

Reflection question

Time for a break. But think about the questions below and how you would answer them. Write down your thoughts and add them to your notes:

1. What problems, if any, can you see for consumers with the use of standard form contracts?
2. What does the term 'agreement' mean to you? How often do you think you enter into an agreement and what it means legally?

PROBLEM:

FACTS: You and another athlete were both boxers competing for Olympic selection but only one could be selected. To be selected, you had to sign a Selection Agreement, an Athlete Nomination Form and a Team Membership Agreement. The documents, which used expressions such as 'Agreement' and 'Form', covered a number of matters, including an exclusion clause accepting that the Court of Arbitration for Sport (CAS) was the final court of appeal. You were initially nominated to represent PNG in boxing. The other competitor unsuccessfully appealed that decision to the Boxing Federation of PNG Appeal Tribunal, but then successfully appealed to the CAS. You then sought leave to appeal the CAS award and the matter was heard in the PNG Supreme Court.

ISSUE: Could you win? Did the Supreme Court have jurisdiction?

DECISION: ?

HINT: How carefully did you read the facts because they contain the answer?

What are the rules relating to offer?

In determining whether there is a valid offer or something else (for example, invitation to treat, inquiry or supply of information which **cannot**be accepted), there must be:

- an intention or willingness to be bound
- a firm promiseor clearly stated offer; **and**
- communication of the offer (preferably **in writing**if the transaction is important to you, though it can be **oral**or **by conduct and by you as the offeror or a person authorised to make the offer or communicate it** (as in, your agent).

The following rules apply to offers generally:

- They may be made to one person, a group or to the world at large

- They may be kept open if supported by consideration (this is known as an option)
- All terms must be brought to the notice of the offeree and followed exactly
- They may be terminated.

What is the meaning of 'offer'?

An offer is a clear expression of the termsunder which a person like yourself is prepared to enter into a contract with another person and be bound by their acceptance of those terms. There is a definite intention to be bound. But note only an offer can be accepted and lead to agreement.

No particular form is requiredfor the making or delivery of an offer. This can be contrasted with an acceptance, where the offeror may require the offereeto accept in a particular form or way (for example, by accepting in writing, only by mail or only by email).

The offer creates for the offeree(a person, a class of persons or the world at large to whom the offer is directed and who can accept the offer) the ability to subsequently create a contract if they unconditionally accept the terms of your offer (the offeror is the person making the offer) and all the other elements necessary to establish a contract can be satisfied.

What makes a statement an offer depends on what the parties had in mind(as in, the intention of the parties, which is considered in Chapter 6) at the time the statement was made.

In many disputes it will be impossible to determine what the parties were thinking, so the courts will rely on an 'objective testof a reasonable person'. That is, **would a reasonable person have thought that the offer you made was with the intention of being bound as soon as it was receive by the other party?**

What the parties want to call the statement does not really matter. They may call it an 'offer', but in reality, it may indicate only a willingness to negotiate or be an indication of the price that a person may be prepared to sell at, while at this stage they don't intend to be bound. In other words, **there must be an explicit offer**. For example, you send Jax an email saying 'Will you sell me your property?' and Jax replies 'Lowest price K900,000'. This will be taken to be only a response to a request for information.

If it is clear in the circumstances that a party intends their words or conduct to constitute an offer, then the courts will be prepared to construe it as such. An example of where an advertisement was considered to be an offer rather than one inviting offers (called 'an invitation to treat') was *Carlill v Carbolic Smoke Ball Co[1893] 1 QB 256 ('Carlill v Carbolic*

Smoke Ball Co'). The court found that the words used in the company's advertising were sufficiently specific to show to a reasonable person that it intended to be bound.

Reflection question

Case

Read the case of *Carlill v Carbolic Smoke Ball Co* and see if you agree with the result?

Look at a copy of the advertisement to help you decide whether you have a problem with the advertisement.

Having read the court's decision, consider the following questions:

- who were the parties (the plaintiff and defendant)?
- Briefly summarise the facts.
- What were the issues before the court?
- Why did the court find the advertising could be construed as an offer?
- Just as a matter of interest, would you sue if you had bought a product that the seller guaranteed would work and it didn't?

Similarly, the use of words such as 'rain check' or phrases such as 'until stocks run out' or 'one per customer' suggests that the offeror intended the offer to be promissory rather than a calling for offers.

Business tip

Look carefully at the words and/or conduct you use if you are the party making the offer (the offeror). Are they promissory or not? Could they amount to an offer? The

question you must ask is whether from the language used or the actions of the parties, was there an intention or willingness to be bound?

What is the importance of communication?

How you as the offeror wants to communicate or make your offer is entirely up to you, but **only you (or your authorised) agent can communicate the offer**. How else would the other party know that you were intending to make an offer if you didn't tell them?

In the English case of *Powell v Lee (1908) 99 LT 284*, Powell applied for the position of headmaster of a school and the board of the school passed a resolution appointing him. The board didn't immediately notify Powell of its decision, but a member of the board privately told him his offer of employment had been accepted. The board subsequently rescinded its decision and appointed another person. In this case the court held that there was no contract between Powell and the board as the resolution was not conveyed by anyone with authority.

Communication can be in:

- **writing** (including via the internet or text message)
- **orally**; or
- by **conduct**.

Regardless of the method chosen, **it is vital to the formation of a contract that the offeror indicates an intention or a willingness to be bound** by the offer, otherwise it will be seen as an invitation to commence negotiations, or the soliciting of an offer.

Business tip

Put the offer in writing if it is important

If the proposed contract is important, then put the offer in writing for the purposes of certainty and reducing potential exposure to expensive litigation. The terms of the offer

must be clear enough for the offeree to be able to decide whether to accept or reject your offer, and should include at least the following:

- Identify who the parties are
- Identify the subject matter, and quantity if it is goods
- Consideration (usually in dollars) to be paid (how, when, and where)
- time of performance method of acceptance; and
- Method of performance.

Is an invitation to treat an offer?

An invitation to treat is **not an offer**. It is an invitation to a party to make an offer and **cannot be accepted** by you if you are the other party. The party making the invitation to treat does not intend to be bound. It is an expression of a willingness to start the offer and acceptance process, which in time may produce an offer and acceptance but until that point is reached, it cannot form a legally binding contract.

Even the use of the word 'offer' may not be enough to demonstrate an intention to be bound. In these circumstances, **it is the party who responds to the invitation who will be the party making the offer.**

Invitations to treat are a part of everyday life more often than you think. Instances generally considered to be invitations to treat include:

- auctions
- the advertisement of tenders
- goods placed on shop shelves and in shop windows
- goods/services advertised in catalogues or newspapers, or on radio, television or the internet; and
- price lists, circulars and catalogues.

For the purposes of commercial reality and commercial practicality, the courts have accepted that goods on display in a shop or supermarket, advertisements or price lists circulars and catalogues are to be treated as invitations to treat unless there is something to clearly indicate otherwise, such as a sign making it clear that the goods on display are on 'sale' or a 'one-off price'. Imagine if the goods on the shelves were treated as offers. If you

took them off the shelves wouldn't that constitute your acceptance? Returning them could then amount to a breach of contract!

Are self-serve situations invitations to treat?

Not all self-serve situations can be considered invitations to treat. Automatic vending machines, such as drink, confectionery and ticket dispensing machines, as well as self-serve petrol stations, are **not**considered to be invitations to treat. The reason is found in commercial reality and practicality: How would you return the goods?

What about advertising of goods or services in the media or online?

Generally, the advertising of goods or services in newspapers, on the radio, television or the internet, as well as price lists, circulars and cataloguesshould be regarded as invitations to treat. Generally, there is no indication of intention to be bound on the part of the advertiser. But you need to read the advertisement carefully to determine whether it is an offer or an invitation to treat.

However, while advertisements are generally regarded as invitations to treat, it is always possible for the advertiser to make it clear in the advertisement that they intend to be legally bound as *Carlill v Carbolic Smoke Ball Co* (an English case) illustrated above. In the case the court considered that the wording of the advertisement was such that it could only considered as an offer to the world at large because the company was guaranteeing to pay £100 to anyone who contracted influenza after purchasing the advertiser's smoke ball, and it had deposited £1000 into the bank as an indication of its sincerity.

For online retailers of goods and services, generally the prices online are an invitation to treat. If you shop online, where do you stand when a mistake arises? To avoid problems arising with customers over pricing mistakes, the retailer's terms and conditions must clearly outline that it is generally the customer who makes the offer and the retailer who accepts or declines that offer.

Note that a statement is not an offer if it expressly provides that the person making it must perform some further act before they are bound – for example, paying a deposit or signing it. **The offer must be unconditional**or else it will be an invitation to treat.

Are auctions invitations to treat?

An advertisement for an auction is not an offer to hold it but an invitation to treat –that is, it is inviting people to come along and make offers or bids. If you go to an auction

and it is cancelled, you have no remedy against the auctioneer as you have no contract with them. The advertisement of the auction was not a guarantee that it would be held but simply a declaration of intention or an invitation to treat.

When an auction is held with a reserve, as in, where the auction has a minimum sale price, it is only when the hammer falls that a contract is formed. If that were not the case, every time a higher bid was made there would be a breach of contract. Up until the hammer falls, which formally signifies acceptance, the auctioneer can choose whether to accept a bid or even indicate that a bid previously accepted is no longer valid. Where the auction is held without a reserve, the auctioneer makes a unilateral offer which is accepted by the person submitting the highest bid.

The vendor can withdraw the property from sale at any time before a bid has been accepted and, likewise, a bidder can withdraw any offer they have made up until the hammer falls. Remember, **acceptance occurs on the 'fall' of the auctioneer's hammer, and the auctioneer then becomes the agent for the buyer.**

What is the effect of a request for information?

Distinguish a counter-offer from a mere **request for further information. Thelatter does not destroy the offer**. If there is nota firm promise, there is not a rejection of the original offer by the counter-offer.

A party who supplies information that has been requested is not intending to be bound by that response and, as a result, it is not usually viewed as an offer. For example, you see a car parked in the street and you approach the owner and ask if the car is for sale. They say, 'Lowest cash price is K$42,500' and you reply, 'I agree. That is a fair price.' You have a problem as your initial enquiry is not an offer. The court will treat the owner's response as nothing more than **an indication of the minimum price they might sell the vehicle for**. Your response is not acceptance but an offer to buy (you are the offeror) and it is up to the owner (who is the offeree) to accept or reject your offer. There is no contract.

The person providing the information can, of course, include words in their response which make it clear that an offer is intended – for example, by saying, 'I am prepared to sell my car to you for K$12,500. Please confirm your acceptance by return mail.'

What is the effect of a statement of intention?

Generally, a statement of intention is nothing more than a declaration by a party that they are prepared to buy, sellor trade.There is usually no intention that their statements

or actions are to be legally binding, although in each case the statements **must**be viewed in context.

What is the effect of words such as 'subject to contract'?

It is possible to negate the effects of intention in an offer by including in any documents a proviso that states the agreement is 'subject to contract', or 'not valid until signed' or some similar requirement. But be careful because the court will make an objective assessment of what the parties intended, taking into account the subject matter of the agreement, the status of the parties to it, the relationship between them and other surrounding circumstances, and whether a reasonable person would have concluded that a binding contract had been made.

Some rules about offers: When does an offer become effective?

Common sense would suggest that**an offer is not effective until it is brought to the notice of the person to whom it is directed**. Knowledge of the offer by the offeree is paramount. If the facts show that if a person has acted in ignorance of an offer, or that they didn't do the act with the intention of accepting the offer, there will be no acceptance and therefore no contract.

Who you make an offer to is up to you, but it can be:

- a **particular person**, in which case only that person can accept or reject it
- a **group of people**, in which case any person within that group may accept or reject it; or
- the **whole world** (frequently by way of advertisement), where any person who is aware of the offer may accept it by complying with the terms of the offer.

In *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256 above, remember the Smoke Ball Company published advertisements in newspapers during an influenza epidemic claiming that anyone who used its 'smoke balls' according to its instructions would not catch influenza. If they did after using the company's smoke balls, they would receive £100.

The advertisement was an offer made to all the world. Acceptance took place when a person came forward and, in reliance of the advertisement, performed the necessary conditions (which Mrs Carlill did by her performance of the conditions contained in the advertisement).

Carlill's case is an example of a **unilateral**contract – that is, a contract constituted by an offer of a promise for an act, rather than the usual exchange of promises. There is only one

promisor, and acceptance is by performance. This can be compared with a bilateral contract where there are mutual promises between the two parties.

What is an option?

The purpose of an option is usually to give the offeree time to consider whether they do in fact wish to buy the item under consideration, or to raise the necessary finance. In such a case, an option will arise if you as the offeror promises to keep the offer open for a **specified period.**

An option will be unenforceable unless it is supported by the offeree's **consideration**. Once consideration is given, **the court is not concerned about the amount of the consideration (its adequacy) as long as it exists**and has some value.

Where there is an option in an agreement, if the parties have made no provision as to the time during which the option must be exercised, **the implication is that the option will be executed in reasonable time**—a question of fact depending on the circumstances in each case. For example, 16 months to exercise a clause in a partnership agreement to acquire the share of a deceased partner was not reasonable, even though the agreement did not specify a time limit to exercise the share option.

Business tip

Options and return of the consideration

The use of an option supported by consideration by an offeree can prevent you as the offeror from revoking your offer for a specified period. It also means that you have also agreed not to sell the item to anyone other than the offeree within that period. However, you should specify in the option contract whether the offeree will recover the deposit money they may have given you if the option is not exercised. If you sell the item on which a deposit has been paid in the option period, then that would amount to a breach of contract and the offeree could sue you for damages.

Do any terms have to be followed exactly?

Any terms or conditions specified by you as the offeror must be met by the offereein accepting the offer, such as 'reply by email only'. **The key word is 'only'**, as it suggests

that you have a particular reason in mind for wanting a reply in this fashion. Any terms or conditions should be brought to the notice of the offeree as they set out the parameters on which you are prepared to be bound. Words like ‘only’ (which means solely or exclusively), must be exactly followed if there is to be a valid acceptance.

Business tip

Notice of terms

If you are making the offer, make it clear what the terms and conditions of the offer are. If a dispute arises, the question for the courts to consider will be whether the parties have, in fact, ever reached an agreement. This is always a question of fact to be decided objectively based on whether a reasonable person would have concluded that an offer had been made.

How can an offer be terminated?

Termination

Termination must be done before acceptance(except in the case of a ‘condition subsequent’; see ‘Lapse by failure of a condition’ later in this chapter) and can only be revived by the offeror if you are the offeror.

Revocation (cancellation, withdrawal)

For a revocation to be effective, the offeree must be made aware that the offer has been withdrawn before acceptance can take place. Generally, there is no required method or special form of language required for revocation to be effective, if it is communicated before acceptance takes place. What must be established is that:

- notice of revocation has been sent to the offeree; **and**
- the offeree has been made aware of the revocation before they have accepted the offer.

If you are the offeror, you can still withdraw the offer even if you said that it would remain open for a specified period, but this is provided that the offer was not given under seal or supported by consideration.

If the offeree had become aware of the revocation of your offer from a reliable source, which does not just have to be you, and it was therefore clear to the offeree that you no longer wished to proceed, the offer is validly revoked. Communication of the withdrawal to the offeree's agent can be effective if it is within the agent's actual or apparent authority to receive such a communication.

Note the method used to communicate the offer because, unless the offer states otherwise, acceptance should be communicated by the same or a faster method. Also note the date and time of receipt of the offer and if there is revocation of the offer, when was it received by the offeree (before or after acceptance by the offeree)?

Rejection or counter-offer

An offer may be terminated expressly by the offeree through their words or conduct. It may also be terminated by implication by a counter-offer, which also amounts to a rejection. A counter-offer is an express or implied rejection of the offeror's original offer by the offeree – for example, the price for goods or services – and the introduction of a replacement offer. If you offer to sell your car to a potential buyer for K10,000 and they offer you K9000, which you reject, can the buyer then accept the original price of K10,000? The answer is 'No'.

The effect of the counter-offer is to permanently revoke the earlier offer by you and to substitute a new one by the buyer in its place. Effectively, you, as the original offeror and the buyer, as the original offeree, have changed roles. You are now the offeree, and you have the choice of accepting or rejecting the 'new' offer. The only way that the original offer can be revived is if you choose to revive it. Otherwise, there is no agreement between you and the buyer.

It is necessary to distinguish between a counter-offer and a request for information. **A request for information generally does not cause the offer to lapse as it is not considered a counter-offer.** In the case of your car, if the potential buyer asks, 'Does the car have a roadworthy certificate?', your original offer still stands. The buyer (the offeree) has neither accepted nor rejected your offer, they have merely made a request for information.

Lapse of time

If you (as the offeror) specify a time during which the offer will remain open, it remains open only for that time. It may be withdrawn by you before that time by notifying the people to whom the offer was directed that the offer has been withdrawn, but this must occur before there has been an acceptance. Note that if the offer is made but there is an

option to keep it open for a specified time that is supported by consideration, then the offer cannot lapse (or be withdrawn) until the expiry of that time.

Where no time limit is specified, the offer remains open for a reasonable time. **What 'reasonable' means will depend on the circumstances of each particular case**, but it includes the language used by the parties (including any stipulations contained in the offer or which might affect its acceptance) and the subject matter.

Is there a time factor that needs to be considered? An offer will be short-lived in the case of perishable goods or goods for which the price fluctuates quickly in the market (for example, oil, gold or even the currency market). In the case of land, providing that there is nothing in the offer to indicate a degree of urgency, the offer will remain open for a longer time but not indefinitely.

Business tip

Where no time has been specified for the acceptance of an offer, it must be accepted within a reasonable time. What constitutes a 'reasonable time' will depend on what the offer is for. In the case of perishables, for example, the offer will remain open for only a short time. But just note that if a person accepts an offer after it has lapsed, while the acceptance itself will not give rise to a binding contract, there is no reason why you, if you are the original offeror, couldn't treat it as an offer and accept it.

Lapse by death of either party

The effect of death on the offer will depend on several factors, such as:

- the nature of the contract (for example, was it to be a contract of a personal nature? For example, to paint a portrait of your family); **and**
- the knowledge of the other party.

Death will terminate a contract only where it is for personal services. If there is no personal involvement of the offeror in the offer, the estate of the deceased offeror may be liable in contract.

If the offeree learns of your death (and you are the offeror) before acceptance of the offer, then a purported acceptance will be ineffective because the offer will have lapsed. But

where the offeree is unaware of your death, it is possible that a valid acceptance can still bind your estate if the offer does not involve the personal involvement of the deceased offeror.

Lapse by failure of a condition

If an offer is made subject to a condition and this condition is not fulfilled, then the offer will lapse. For example, a clause or term in the offer stating 'reply by email' indicates a degree of urgency, and so acceptance by mail would not comply with the stipulation, thus causing the offer to lapse.

A condition precedent**is a clause or term in the agreement** stating that the agreement**does not become a contract until the happening of a specified event**.For example, a 'subject to finance' clause in an agreement, if not fulfilled, causes the offer to lapse.

A condition subsequent **clause in a contract may cause the contract to terminate**, if the parties have stated that the occurrence of a particular event will give the parties that right. Just note that here **the contract is already in operation.**

Reflection question

That is the end of the rules relating to offer. So, take a break but first have a look at the following questions and see if you can answer them for revision.

1. Explain what an offer is
2. List and explain the main rules relating to an offer
3. Explain what is required for an offer to be validly accepted
4. Explain why it is necessary to distinguish between an offer and an invitation to treat from the perspective of both a customer and a seller
5. Under what circumstances will an apparent invitation to treat situation become an offer?
6. Explain under what circumstances an offer can be terminated
7. Explain the difference between a condition precedent and a condition subsequent and give an example of each in relation to the purchase of a car.

What are the rules relating to acceptance?

An **acceptance converts the promise or promises of you as the offeror (represented by the offer) into an agreement**. Before acceptance of the offer, neither party is bound to the agreement;**after acceptance, both parties are bound.**

Acceptance contains two elements:

- a willingness to take exactly what is offered; **and**
- an agreement to pay the 'price' required.

In brief

Rules as to acceptance

If there is to be agreement, the acceptance:

- must be made in reliance on the offer
- must be strictly in accordance with the terms of the offer
- must be communicated to the offeror orally, in writing or by conduct
- cannot be a cross-offer (discussed below)
- can be accepted only by the party to whom the offer was made
- must be absolute and unqualified; and
- once made, cannot be revoked without the assent of the offeror

When the offeree accepts your offer by either promising to perform (as in, a promise to do or refrain from doing an act), thus creating a bilateral contract, or performance of the act requested by you as the offeror creating a unilateral contract they become known as the acceptor.

Methods of acceptance

Once you have got the question of offer sorted in your mind, you now need to turn to the question of acceptance. Acceptance **may** be made:

- in writing
- orally
- by a combination of orally and in writing; or
- by conduct.

However, if acceptance is to occur, it **must**conform with any conditions that might be required by you as the offeror. Again, **the courts use an objective test**to determine whether an acceptance has taken place, as in, **what would a reasonable person have thought or done?**In this case, would a reasonable person have thought there was an acceptance of the offer?

Must acceptance be made in reliance on the offer?

The offeree must intend to accept your offeror there can be no agreement between the parties. Acceptance must clearly be made in response to, and because of, the offer.

Where you specify a special or particular method of acceptance, **it must be followed exactly**. So, if you are renting a unit, house, or business premises and the lease contains a term about punctual payment of rent, then failure to pay regularly and on time means there is little chance of the lease being renewed by the landlord because you are not carrying out one of the conditions prescribed in the lease agreement.

Where no method of acceptance is indicated, the custom of the trade or what is reasonable in the circumstances will be good acceptance. Thus, an offer by SMS suggests the need for a prompt reply, so any method equally as fast or faster will be effective.

Must acceptance be communicated to the offeror?

As a general rule,**acceptance must be communicated, either by words or conduct**, otherwise how will you know whether or not you are bound by your offer. In other words, some positive act on the part of the offeree indicating an intention to accept is required. **Silence**on its own on the part of the **offeree**is **generally insufficient**to create a contract, just as the imposition of an acceptance by you on the offeree is insufficient.

There are **situations where silence can amount to acceptance** which include:

- where the **offeree** has signed an agreement indicating continuing acceptance of delivery until further notification – for example, subscriptions to internet services or membership of a local gym debited on a monthly basis, where the offeree, by their conduct, has allowed work to go ahead and made progress payments and where you dispense with the requirement of communication, and acceptance is to be by performance of an act

- where there is a history of prior dealings between the parties
- where it is just and equitable – for example, where the conduct of the proposed tenant led the owner to believe that the tenant would lease the premises and the owner went ahead and undertook major demolition and construction work in that belief
- by **conduct**, where the parties by their actions show that they intend to be bound; and
- where the postal rule applies (see below).

The ultimate issue is whether a reasonable bystander would regard the conduct of the offeree, including their silence, as suggesting to the offeror that the offer has been accepted.

Who can accept an offer?

Only the person or persons to whom the offer was directed, or their authorised agent, can accept the offer.

If someone else tries to accept the offer, that 'acceptance' is probably only at best an offer itself, which you, if you are the original offeror, are now the offeree, can accept or reject as they wish. Where the offer is made to the world at large, acceptance is by those members of the public who perform the conditions set out in the offer.

Can cross-offers give rise to a contract?

The fact that the offers are identical is irrelevant. Contract law demands an acceptance, and **with cross-offers there is no acceptance.** Going back to your offer to sell your car for K10,000 (above), if the potential buyer, in ignorance of your offer, makes you an identical offer of K10,000 for your car at the same time, then you have a cross-offer. There is not a contract, because the promise or offer being made on one side in ignorance of the offer on the other side cannot be construed as an acceptance of the other.

Does acceptance have to be absolute and unconditional?

A conditional assent is not an acceptance. For example, if a document contains a clause to the effect that it is 'subject to a formal contractto be drawn up by our solicitors', a contract does not come into existence until a formal document has been drawn up and accepted by the parties. The first document is **merely a proposal to enter into a contract,** a tentative agreement that may be disregarded by either party. Whether the parties have reached final agreement on the terms of their bargain is a **question of fact** in each case, and the basic test is always**whether a reasonable person would regard themselves as being bound by what they said and did.**

Reflection questions

Time for a break. While you are taking a break think about the following questions on the topic of acceptance. Take some notes as you read through them.

1. Does acceptance have to be made strictly in accordance with the terms of the offer?
2. Can anyone accept an offer even if it is made to them?
3. Can silence ever amount to acceptance?

Can you create a contract by post?

Today, a great many business negotiations, and even shopping, are handled via the internet. In the case of business contracts, PDF files are often exchanged via emails by the negotiating parties, who use software programs to amend them. Negotiations are often handled by means of video-streaming services. Final versions of documents are agreed via emails and are often signed by way of an electronic signature.

In the case of online shopping, the buyer sends an offer by clicking on an icon or a button, which indicates agreement by acceptance of the terms and conditions (a 'Clickwrap Agreement'). Part III of the *Electronic Transactions Act 2021*sets out the rules on contracting by electronic communication.

The use of the post office as the primary medium for the exchange of promises is rapidly being replaced by technology such as electronic communication in the form of emails and text messages. It is foreseeable that the traditional role of the post office, as a delivery vehicle for letters, may become redundant in the not-too-distant future and that it will evolve into a parcel delivery service to meet the delivery needs of online businesses as it is doing in Australia. However, as that time has not quite come, it is still important for businesses to understand the rules relating to contracts by post.

Using the post office

Where the parties contemplate the use of the post as a medium of exchange of promises,

the offeror must have **contemplated and intended**that the offer be accepted by the act of posting, in which case the rules as to the time of acceptance change. Thus:

- an offer made by letter is not effective until it is received by the offeree; and
- acceptance is effective as soon as it is posted.

If the letter is properly addressed, prepaid (it has a stamp) and put in a post box, a contract is formed at the place when and where the letter of acceptance is posted. **The post office is your agent**,and this means that communication to the post office is communication to you.

The courts have decided that you have indicated a willingness to accept the risks of the letter being lost, delayed or destroyed by using the post as your agent. You had the opportunity to specify, in your offer, any other form of communication to reduce these risks and you chose not to. **By posting the acceptance, the offeree has done all that is required of them.**

If revocation**of the offer**is to be effective, it **must**be received by the offeree before they post their letter of acceptance. How the offeree receives notification of the revocation of the offer is irrelevant as long as it is **clear that you, as the offeror, has withdrawn the offer before acceptance has taken place.**

What commonly occurs in business is that an offer is usually expressed in such a way as **to exclude the operation of the postal rule by requiring actual communication** of the acceptance – for example, by the offeror including a term in the offer stating ‘acceptance shall only be effective on receipt at this office’.

Business tip

In cases of contracts by post, there are three points to note:

- Read the letter of offer carefully. Does it exclude the operation of the postal rule? (Most contracts of insurance exclude the postal rule, so acceptance occurs on receipt, and even then, usually only on clearance of payment of the premium.)
- Revocation of an offer does not have to be by mail just because the offer was sent by mail. A reply by some other means that was just as fast or faster would

be sufficient. What is important is that the offeree receives notice of the revocation before they can accept.

- Check with the post office how long delivery will take if acceptance is an important condition of agreement and the postal rules are to apply for acceptance. Priority letters take one to four business days from posting, depending on place of lodgement and destination locations, while regular letters can take four to six days.

If the delay is the fault of the offeree – for example, if the offeree has misaddressed the letter or failed to post it – then acceptance would occur on receipt (if the letter arrived at all).

Once the offeree has accepted the offer, the normal rules of contract law apply, and the agreement is binding on the parties unless they agree to release each other.

How does electronic offer and acceptance work?

Email, the internet and contract formation

The use of electronic means to complete business transactions, rather than the traditional method of doing business face to face and exchanging paper-based documents, is becoming commonplace. Global e-commerce sales now account for sales worth billions of dollars.

Broadly defined, e-commerce is business conducted by means of computer, the internet and other telecommunications links such as electronic data exchange (EDI). *The Electronic Transactions Act 2021*provides a legal framework to support and encourage businesses and consumers to use e-commerce by providing that the law must treat electronic and paper-based commerce equally.

Online reference

The *Electronic Transactions Act 2021* can be found online on the National Parliament of Papua New Guinea government website.

The main features of the electronic transaction's legislation include the following:

- A transaction is not invalid because it took place wholly or partly electronically (s 9)
- A requirement to give information in writing can be satisfied if the person gives the information by means of an electronic communication (s 10)
- A requirement to produce a document in hard copy can be satisfied by producing the document in electronic form (ss 11, 12)
- A requirement to record information in writing, to retain a document in hard copy or to retain information that was the subject of an electronic communication can be satisfied by recording or retaining the information in electronic form (s 13)
- In relation to the time and place of dispatch and receipt of electronic communications ((s 15) provides that dispatch and receipt are at the originators and addressee's places of business), unless the parties agree otherwise, the following rules apply:
  - the time of dispatch of the electronic communication occurs when the communication leaves an information system under the control of the originator or, if it has not left the information system under the control of the originator, the time when it is received by the addressee (s 16(1) (2)); and
  - the time of receipt of the electronic communication is the time when the electronic communication is capable of being retrieved by the addressee or, if no system is designated, when the electronic communication comes to the attention of the addressee (s 16(3)).

What is the formation of an electronic contract?

The formation of an e-contractis no different from the formation of a conventional contract.The uniform electronic transactions legislation attempts to clarify the rules on:

- the use of automated message systems for contract formation (s 6);
- the location of the parties (s 7); and
- updating the electronic signature provisions and default rules for:
  - time of dispatch (s 16(1))
  - time of receipt (ss 16(3), 17); and
  - place of dispatch and place of receipt (s 16(6)).

If you access an online supplier, you will usually be considered to be an offeror who intends to buy a product or service and is generally assumed to be intending to contract. The agreement generally arises between the parties when you make the offer by clicking on the 'Buy', 'I agree' or 'I accept' button or icon. The offer is sent when you click on the 'Send' button. Acceptance occurs when the supplier communicates an acceptance, and this is received by you. To ensure unambiguous consent, most sellers will require you to change the default setting from 'I do not agree' to 'I accept' or 'I agree'.

Having established that agreement and intention to contract are present (the latter can be implied because of the way the transaction is entered into), the final requirement for the creation of a simple contract – consideration – can be done electronically.

It is then necessary, as it is with a conventional contract, to determine whether the simple contract that has been created electronically is enforceable. This means consideration of three more factors: do the parties have legal capacity to enter into a contract, is there real agreement between the parties (called 'consent') and is the e-contract legal? Form is not an issue here.

A problem with e-contracts is legal capacity. You, as the buyer, are a minor and the goods or services are for necessaries (goods and services that are necessary to a minor, such as food and accommodation), then the contract will be binding. Whether it is enforceable will depend on what country the seller lives in whether it is worth his/her time in suing you. In other cases, involving the issue of capacity, such as buying 'R' rated products or services, the situation is more problematic.

Just as an aside, if each of the requirements is satisfied, a valid e-contract is created between the parties, but what have the parties agreed to? This is an issue about contractual terms (see chapter 11 'Construction of the Contract'). Often, clicking the 'Buy', 'I agree' or 'I accept' button will result in the terms set out in the website being incorporated into the contract. But this raises two further issues:

- What terms have been implied in the e-contract? This can be a real problem where the contract is for software, where there is an annual renewal charge and the seller imposes a term that states that the contract will renew automatically unless the buyer expressly notifies the seller they are not renewing.
- Was notice of the terms given before or after the contract was formed? For example, if the e-contract contains an exclusion clause, notice of such a clause after the contract has been formed is ineffective in common law jurisdictions. Notice must be brought to the attention of the buyer before the contract is made.

Business tip

Doing business by email or on the internet

To minimise problems with contract formation where the method of transaction is email or the internet, the person controlling the transaction should make it clear what is to be taken as an offer or what is required for an acceptance, and when electronic communications are to take effect.

If the parties do not intend to be bound until the final agreement, this should be clearly stated in your emails by including a statement along the following lines in each email: 'No binding agreement is intended to be formed unless and until a formal contract has been executed'.

It is also useful, if the parties are in different jurisdictions, to include choices of jurisdiction and law clauses. In the event that a dispute should arise between you and the other party, by stating which jurisdiction and laws should deal with the matter if a dispute arises. It may be much cheaper and more beneficial to have the matter dealt with in PNG under PNG law.

Reflection questions

Your last break. While you are taking a break think about the following questions on the topic of acceptance. Take some notes as you read through the questions and you can add them to your revision notes.

1. Could an offer sent by email be accepted by letter if the offeror had not specified a particular method of acceptance? Give reasons.
2. Explain why the rules on acceptance should differ between contracts by post and contracts by instantaneous communication such as email.
3. How can businesses that make offers over the internet protect themselves from the

risk of loss associated with the rules of offer and acceptance?

PROBELM:

FACTS: La Forrest (the appellant who lived in Queensland) had brought an action against a number of parties for injuries she suffered in December 2022 when staying at a Casino Hotel in PNG. Correspondence ensued between the various parties about settlement, with email a common form of communication between the parties in the later stages of this matter. On 24th December 2023, La Forrest sent an email at 5.42 pm, referring to an offer of settlement made on 22 December 2023, to solicitors of two of the defendants, advising them that she was prepared to accept their offer. At 6.08 pm on the same day (22 December), the solicitors confirmed acceptance of the offer and indicated that they would prepare discharge papers on 5th January 2024. On the 6th January 2024 the defendants forwarded the discharge papers to La Forrest, who then found the terms unacceptable and declined to sign them.

ISSUE: Did La Forrest accept the offer? Was acceptance by email capable of creating contractual relations?

YOUR DECISION: What do you think would be the outcome? Why?

HINT: The times are important.

Key points

An understanding of the following points will help you to better revise material in this section on agreement.

- **Why is it important to establish whether the parties have reached an agreement?**The agreement goes to the heart of a contract because, unless the parties are in agreement, there isn't a contract. Agreement represents the culmination of a negotiating process between the parties.
- **What is an agreement in a traditional sense?**Agreement arises when there has been an 'offer' by one party and an 'acceptance' by another.
- **What other techniques may a court resort to in order to determine whether there is an agreement?** The techniques that a court may resort to include assessing the conduct of the parties and a global approach looking at all of the correspondence

between the parties, their acts and conduct, to see whether there was agreement on all important terms.

- **What are the rules relating to offer?**The rules relating to offer include: distinguishing an offer from an invitation to treat (preliminary communications between parties at the negotiation stage are not considered offers.
    - communicating the offer by writing, orally or by conduct, and bringing it to the notice of the person to whom it is directed (doing something without knowing of the offer is not acceptance)
    - determining to whom the offer is made: an individual, a group of people or the world at large *(Carlill v Carbolic Smoke Ball Co)*
    - determining whether the offer has an option attached to keep it open for a specified period and whether that option is supported by consideration; and
    - ascertaining whether all the terms of the offer have been brought to the notice of the offeree and followed exactly.
- **What is the difference between an offer and an invitation to treat?**An offer is characterised by an intention or willingness to be bound. An invitation to treat is only an expression of a willingness to start the offer and acceptance process, which in time may produce an offer and acceptance. Unlike an offer, if you are making an invitation to treat it means you do not intend at that point in time to be bound. You are inviting someone to make you an offer.
- **What are the ways in which an offer may be terminated?**An offer that has not been kept open by an option supported by consideration may be ended by revocation or withdrawal.
    - rejection or counter-offer
    - lapse of time
    - lapse by death of either party; or
    - lapse by failure of a condition.
- **What are the rules relating to acceptance?**If there is to be agreement, the following rules relating to acceptance must be considered:
    - must be made in reliance on the offer—that is, the offeree must intend to accept the offer
    - must be strictly in accordance with the terms of the offer
    - must be communicated to the offeror orally, in writing or by conduct, otherwise the offeror will not know whether or not they are bound – silence on the part of the offeree is not enough, unless agreed to by the parties
    - can be accepted only by the party to whom the offer was made or their authorised agent *(Carlill v Carbolic Smoke Ball Co)*
    - cannot be a cross-offer, as each party is ignorant of the promise of the other and acceptance presupposes that there is an offer by one party and an acceptance by the other

    - must be absolute and unqualified, or it may amount to either a counter-offer or a tentative agreement; and
    - once made, cannot be revoked without assent of the offeror.
- **How does the postal rule operate?**Where the parties contemplate the use of the post to create a contract, the offer is effective only on receipt by the offeree, with acceptance occurring on posting by the offeree unless the offeror includes a term in the offer to the effect that 'acceptance is only effective on receipt of notification of acceptance'. For revocation of the offer to be effective, the offeree must receive notice before they post their letter of acceptance.
- **What rules apply to communication via the internet?** Where the communication of acceptance is via the internet, the *Electronic Transactions Act2021* applies in place of the postal rules.

6.

INTENTION TO CREATE LEGAL RELATIONS

Learning objectives

On completion of this Chapter, you should be able to:

- Explain the need for legal intentions in contracts.
- Explain what intention to create legal relations means.
- Explain how the courts determine intention to create legal relations.
- Distinguish between non-commercial and commercial agreements.

Key terms

Here are some terms you will encounter in this chapter, which will help you to better understand this chapter:

domestic agreements – agreements made between family members and relatives where there is no intention to create legal relations.

- **Objective test:** would the words or conduct of the parties lead a reasonable person to believe, on the balance of probabilities, that legal relations were intended.
- **Presumption:** a belief (as the word is used here it is a reference to what the courts assume).
- **Social agreements:** agreements made between friends or acquaintances.
- **Voluntary agreements:** agreements where the parties volunteer their services, usually for no money.

Introduction

Chapter 6 introduces you to the second element that must be present in a simple contract – that is, the question of intention between the parties to create legal relations.

The fact that you have reached an agreement with another party does not necessarily mean that a contract has been created. It is this element of intention that distinguishes a legally binding contract from other types of arrangements. Without intention, you can still have an agreement but it is an agreement that is not enforceable in a court because it is not a contract. The parties will have to rely on moral or social pressure for enforcement.

In this chapter we begin by looking at intention generally (express and implied) and then the two main types of agreement: non-commercial, and commercial or business agreements. In the case of a non-commercial agreement there is a presumption (or a belief) that the parties *do not*intend to create legal relations while in the case of a commercial or business agreement there is a presumption that legal relations are intended.

Step 2 – Intention to create legal relations

In Step 1 you were concerned with the issue of agreement. Was there an offer? Did the other party accept? Once you are satisfied that an agreement has been reached, you need to think about whether the agreement you entered into was legally enforceable. The fact you and the other party have reached an agreementdoes not necessarily mean that a contract has been formed.

For an agreement to be legally enforceable as a contract, you both must intend to create legal relations. This can beexpress(words, writing or conduct) or implied; butif it is not present, there can be no contract.

The question of intention is closely linked to the question of agreement which, together with consideration (see Chapter 7), will determine whether the parties have entered into a simple contract. But notethat even at this stage we don't know whether our contract that we created is valid. That can only be determined after considering the elements of capacity, consent, legality and form (these are dealt with Chapter 8, Chapter 9 and Chapter 10).

Is it difficult to determine intention?

The difficulty with determining intention is trying to work out what the parties really intended.

As you will discover, the parties to a contract rarely make express reference to the question of intention.

It is only when a problem arises between the parties and one party wants to enforce their 'rights' that intention suddenly becomes an issue. Suddenly, the party that feels aggrieved – usually because there is money at stake – will want to know what their rights are – that is, whether there is an enforceable agreement or not.

In trying to find an answer to the question of intention, the courts (in the case of Australia, up until the Australian High Court decision in *Ermogenousv Greek Orthodox Community of SA Inc* [2002] HCA 8 ('*Ermogenous*') classified agreements into two categories:

- **Agreements of a business or commercial nature.** Here the courts had adopted an approach involving a rebuttable presumption (a legal principle that presumes something to be true until evidence is produced by the party who wishes to disprove it proves otherwise) that unless the contrary can be clearly established, it was presumed that the parties did intend to create an enforceable contract.
- **Agreements of a social or domestic nature.** Here there was a rebuttable presumption that the parties did *not* intend legal relations. For example, if you agree to meet a friend at the movies and they don't turn up, you might be upset but you don't usually intend to sue them for breaching their promise to you.

Where problems arise is where the consequences for the aggrieved party are much more serious (for example, in a PNG Lottery win where a ticket holder claims they bought the winning ticket with their money and the ticket bought by the group did not win anything), because now the court has to try to determine what the parties intended when making their arrangement. Did the parties intend their agreement to have legal consequences should things go wrong? This can be quite hard to determine because the parties in these types of arrangements rarely make express reference to the requirement of intention.

How do you determine intention?

Intention can be determined by considering the relevant context and the relationship between the parties and determining what inferences can be drawn from that. Look at what the parties have said, written or done as well as taking into 'account the subject matter of the agreement, the status of the parties, their relationship to one another and other surrounding circumstances.

In brief

Intention and contracts

For an agreement to be legally enforceable as a contract, one of the conditions that must be satisfied is that the parties intended to create legal relations. Intention can be either expressed in words, writing or conduct orimplied,and requires an objective assessment of the state of affairs between them; if intention is not present, there can be no contract. Proving intention can be a difficult legal process.

What form can intention take?

What is express intention?

The parties rarely make any direct or express reference to the question of intention to contract within the contract itself. Where references are made, they are generally found only in commercial(or business) agreementsand they are invariably expressed in a negative way – that is, by way of termsthat expressly and clearly state that the parties don'tintend to be legally bound – for example, by including wording in the agreement such as:

- '***binding inhonour only***' (these are also known as 'honour clauses'). In the English case of *Rose & Frank Company v JR Crompton & Bros Ltd*[1925] AC 445, a commercial arrangement contained the following clause which made it clear that the parties *did not*intend to create legal relations and that the agreement was not meant to be legally binding:

> *This arrangement is not entered into, nor is this memorandum written, as a formal or legal agreement, and shall not be subject to legal jurisdiction in the law courts . . . but it is only a definite expression and record of the purpose and intention of the parties concerned to which they each honourably pledge themselves.*

- An '**honour clause'** was effective in the English case of *Jones v Vernon's Pools*

Ltd[1938] 2 All ER 626 (a case involving a lost lottery ticket) preventing any legal action being taken against Vernon's Pools:

> *It is a basic condition of the sending-in and acceptance of this coupon that it is intended and agreed that the conduct of pools . . . shall not be attended by or give rise to any legal relationships, rights, duties or consequences whatsoever or be legally enforceable or the subject of litigation, but all such arrangements, agreements and transactions are binding in honour only.*

or

- '**This agreement is *subject* tocontract**' or *subject to*the preparation of a formal contract of sale which shall be acceptable to my solicitor'. In both examples there may be an agreement but until a formal contract is made, the parties are not bound. The key word is 'subject' and it tells a court that there is still more to be done, as in, a formal contract has to be made.

Parties to a contract may be content to be bound immediately and exclusively by the terms on which they had agreed. However, they may also decide to add some additional or further terms at a later date. A legally binding contract can still exist even though there is an intention to expand on it to substitute other terms if and when the need arises.

Can the parties exclude the jurisdiction of the courts?

The parties to an agreement can expressly declare that they don't intend to create legal relations. What they cannot do is make a binding contract and expressly exclude the jurisdiction of the courts as this is contrary to public policy – for example, by using wording such as:

> *In respect of any matter arising out of this agreement or any breach thereof the parties hereby acknowledge that the jurisdiction of the court is to be excluded.*

Business tip

Word your contracts carefully. The use of words such as 'subject to contract' suggests to a court that the parties don't intend to be bound immediately. However, it is still

important to look at the agreement as a whole when trying to determine whether the parties intended a binding agreement or not.

If either of the parties don't intend to create any legal obligations, then correspondence between the parties should clearly state that legal relations are not intended.

Take care to avoid using terms that might be construed as an indication of a binding agreement – such as 'binding commitment'. Use expressions such as 'subject to contract'.

What is implied intention?

As noted above, the parties rarely say anything about the issue of intention. It is usually only when a dispute arises that the court tries to determine what the parties intended from their words and/or actions. The central legal question is: Was the agreement intended to be legally enforceable? Unfortunately, this is rarely obvious from the agreement itself.

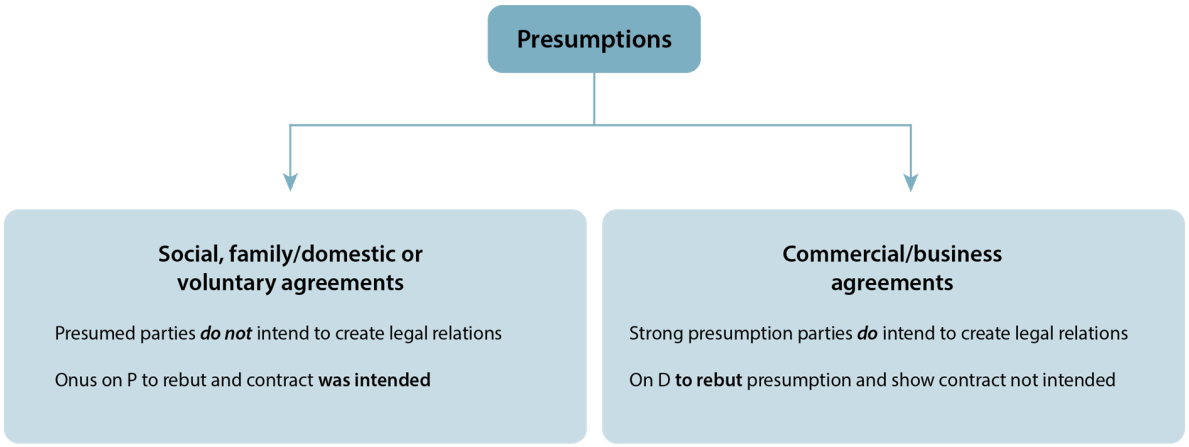
The question to consider when trying to determine intention is what inferences would a reasonable person have drawn from the words or conduct of the parties, having regard to all the circumstances? If a reasonable person assumes that there is no intention by the parties to be bound, then there is no contract.

To assist in trying to determine what it was that the parties intended, the law has treated agreements as falling into one of two categories:

- social, family/domestic or voluntary agreements (non-commercial arrangements); or
- commercial or business agreements.

Traditionally, the determination of intention was then resolved by reference to rebuttable presumptions of fact. In the case of social, family/domestic or voluntary agreements, the law assumed, or presumedthat the parties *didn't intend*their agreement to have any legal consequences if it was not performed as the agreement is unenforceable. In the case of commercial/business agreements, it was assumed, or presumed, that the parties did intend to create legal relations.

Figure 2: Chart explaining the presumption between parties. Image description.



Source: Gibson A (2024).

In both classes of agreement, in determining intention reliance was placed on applying a presumption. The presumption would not apply if one of the parties could produce sufficient factual evidence to satisfy a court, using an objective testinvolving a hypothetical person, that the agreement was intended (or not intended, depending on the class of agreement) to be binding. That is, what inferences would a reasonable person have drawn from:

- what the agreement says
- what the parties have said
- what the conduct of the parties was
- what were the consequences for the parties; and
- the surrounding circumstances.

If the reasonable person after considering these factors assumed there was no intention by the parties to be bound, then there would be no contract.

How has the Australian High Court approached the use of presumptions?

It is not clear whether the PNG National and Supreme Courts will follow the decision of the Australian High Court in a case called *Ermogenous v Greek Orthodox Community of SA Inc*[2002] HCA 8. In this case the High Court suggested that the use of presumptions was merely a useful tool to identify who should bear the onus of proof and that in every case the party asserting the existence of a legally binding agreement bears that onus of proof.

The question in every case was whether an objective assessment of the state of affairs between the parties, in the context in which they were dealing, could be said to show an intention to create legal relations. What would reasonable persons in the position of the parties have understood to have been intended?

Where there is payment of money as consideration for a promise by the other to provide some service or bestow some benefit, the conclusion that can be drawn is that each intended the promise to be taken seriously.

In *Ermogenous* the question of whether the parties could objectively be seen to intend to create legal relations could include:

- the subject matter or topic of the agreement
- the status of the parties
- their relationship to one another
- whether there is a consensus among the contracting parties
- the extent to which it is expressed to be finally definitive of their concurrence
- the way the agreement came into existence
- subsequent conduct or communications between the parties; and
- any other surrounding circumstances.

In a large number of cases the results will be the same as if the agreement had fallen into the presumption categories: commercial/business or social, family/domestic, and voluntary or *Ermogenous*.

Commercial or business agreements

Commercial or business agreements make up the majority of litigated disputes and there is a strong inference in such cases that the parties intended to create legal contractual relations. This is particularly true where the parties are both corporate entities. The relationship between the parties then is going to be a relevant matterin determining whether they had an intention to enter into legal relations.

While there is initially a strong inference that legal relations are intended in commercial or business dealings, if the parties want to show that they didn't intend to create legal relations they need to show, using clear wording such as '…*subject* to preparation of a formal contract…'or 'binding in *honour* only…', that they didn't intend to create legal relations notwithstanding the commercial nature of the agreement.

What is the intention of the parties using a 'letter of comfort'?

In order to secure a loan, a bank or lending institution will try to seek a guarantee from a parent company and, if possible, from the subsidiary company to which the loan is made. This is the only way the lender can be certain that assets of the group will be available to meet the obligations of the borrower should there be a default on the loan. Where the loan

is supported by a contract of guarantee, there is no problem with intention. The liability of the guarantor arises on default of the subsidiary.

But it often happens that a parent company will refuse to give a guarantee – for example, because it does not want a contingent liability to show up on its balance sheet, or it might just not want to be a guarantor. In such a case, a compromise is a **letter of comfort**.

A letter of comfort may take the form of an undertaking to maintain its financial commitment in the subsidiary, or it may be one where the parent company agrees to use its influence to ensure the subsidiary meets its obligations, or it may be nothing more than an acknowledgment by the parent company that a subsidiary has entered into a contract.

In this type of commercial transaction, it is always going to be assumed that the parties intended legal relations, unless it can be rebutted by a clear statement to the contrary. However, whether a statement is seen as promissory or a statement of intention is a matter of construction and taking into account the parties' acts and conduct, including statements they made and documents they signed or dealt with, whether there is a clear indication of what they intended.

Do government 'contracts' always result in contractual relations?

While governments and government departments enter into contracts on a daily basis, there are some types of government dealings that simply don't result in the creation of contractual relations. These usually involve some aspect of the government's political or administrative activities, and here the courts are more reluctant to infer an intention to create legal relations.

Where government schemes or handouts are concerned, the better view is that there is no intention to create legal relations.

What is the presumption in business advertisements?

Where advertisements are concerned, it is presumed that they are *not* intended to create legal relations. As usual, each case should be looked at on its facts to see whether intention is present. A good example where the courts found that the advertisements did create legal relations was *Carlilll v Carbolic Smoke Ball Company* in Chapter 5. The £1,000 deposited at the bank clearly evidenced an intention to pay anyone who performed the conditions of the offer and who claimed the money.

Expressions such as 'one per customer' or 'rain check' by an advertiser in a newspaper advertisement or brochure are intended to make clear to the world at large that if the

advertiser runs out of a product it will get more in at the advertised price for the customer. In other words, there is an intention on the part of the advertiser to be bound by the wording in the advertisement. This is where there is an offer, rather than there being an invitation to treat.

Business tip

Ensure that advertisements accurately reflect the intention of the advertiser

In the case of advertisements, it is presumed that there is no intention to create legal relations. However, advertisers should make it clear in their advertising if restrictions are to apply use wording such as 'subject to . . . availability'. Similarly, the use of expressions such as 'one per customer' or 'rain check', makes it clear to the world at large that the advertiser intends the customer to get the product at the advertised price if it runs out.

Reflection questions

Time for a break. While you are taking a break think about the following questions on intention and again, make notes.

A. Must intention to create legal relations be present in every contract?

B. How can you tell whether an advertisement is an offer or an invitation to treat? Explain.

C. Why do you think that in most agreements of a commercial nature the law assumes that the parties intend to create legal relations?

D. Is it possible to avoid creating legal relations in a commercial/business agreement? Explain.

Do non-commercial agreements lack serious intention?

At common law it was possible to identify three types of agreements as generally lacking serious intention on the part of the parties to create legal obligations:

- Social agreements made between friends or acquaintances – for example, in relation to competitions and lotteries.
- Family or domestic agreements made between family members and relatives, not just spouses, but note that also brings into play customary law; and
- Voluntary agreements, where the parties may volunteer their services without any consideration.

In these types of agreements, the parties *don't* intend to create legal relations, even though the 'agreements' contained promises made by the parties, preferring instead to rely on family or friendship ties of mutual trust and affection. The test is objective, based on the reasonable person with the onus on the plaintiff to produce sufficient evidence to convince a court, on the balance of probabilities, that a contract was intended.

In Australia, after *Ermogenous*, determining the question of intention is by way of consideration of the relevant context and the relationship between the parties, and determining what inferences can be drawn from that.However, whichever approach the court chooses to use is probably going to be the same under either approach.

Are legal relations intended between social and domestic partners?

Traditionally, agreements made in a family context had been considered unenforceable. Thus, for example, in the case of a domestic agreement made while the husband and wife were still living together or in a continuing de facto relationship, it had been presumed that the parties don't intend to create legal relations in relation to any promises they may make to each other. If they are separated at the time the agreement was reached, it is much more likely the parties intended to create legal relations.

Parties to domestic agreements are not restricted to situations involving couples in a relationship. They can extend to other family members, including brothers and sisters, aunts and uncles, nephews and nieces, and in-laws. In each case the onus is on the plaintiff to produce evidence to show that a contract was intended, and the court will look at the words and conduct of the parties to try to determine their intention. In that context, the court will be more inclined to find that intention exists if the consequences of the promise are serious for one of the parties and they have changed their position in reliance on the promise that has been made to them.

If there is ample evidence that would indicate to a reasonable person that the parties did intend legal relations, notwithstanding that the relationship between the parties was one that could be categorised as social or domestic, then the courts seem more than prepared to find that a binding and enforceable contract exists.

In PNG s 9(f) of the Constitution, customary law is recognised as an underlying part of the legal system, and power to deal with family matters such as divorce and financial claims can be dealt with through village courts applying customary law rather than the common law.

Are legal relations intended in voluntary agreements?

Participation in charitable or other voluntary organisations, where a person provides their services for free, is another situation in which the parties don't normally intend to create legal relations.

While there is an agreement, it is usually clear from the surrounding circumstances that a contract was not intended at the time of entering into the agreement. This may not appear to be a problem at first glance, but if the person is volunteering their services for nominal or no payment and are injured, they have no right to workers' compensation coverage under the *Workers Compensation Act 1978* because it is assumed that no contract of employment was intended.

Reflection questions

Time for the final break for this chapter. While you are taking a break think about the following questions on intention and again, make notes.

A. Why aren't voluntary agreements contracts? Explain.

B. Can you list any agreements that you could enter into daily that could result in an inference that contractual relations were not intended?

C. Why do you think that in most agreements of a voluntary nature the law assumes that the parties do not intend to create legal relations?

D. Is it possible to create legally binding agreement out of a social or family relationship? Explain why.

E. In the agreements that you enter into, do you consider the question of intention? Explain why.

Key points

An understanding of the following points will help you to better revise material in this section on Intention.

- **Why is legal intention needed in contracts?** The issue of intention assists the court in determining whether or not the parties have reached an agreement that they intend to be legally enforceable.
- **What is the effect of a lack of an intention to an agreement?** Agreements without intention are agreements that are not enforceable in a court of law.
- **Can the parties exclude the jurisdiction of the courts?** The parties can expressly state that they do not intend to create legal relations, but they cannot make a binding contract and expressly exclude the jurisdiction of the courts.
- **What is the difference between express and implied intention?** Express intention is where the parties make direct or express reference to the question of intention in the contract by way of a term. Generally, express intention is found only in commercial or business agreements.
    - Implied intention, on the other hand, arises where the intention of the parties is not expressly stated. Here, the court has to try to determine from their words and/or actions whether the parties intended legal relations.
- **What is the difference between non-commercial agreements and commercial agreements?** In non-commercial agreements – that is, family or social arrangements, or voluntary agreements – the type of agreement is usually lacking serious intention on the part of the parties to create legal obligations. The onus is on the plaintiff to establish that the parties did intend legal consequences from their agreement.
    - In a commercial (or business) agreement the court assumes that, unless the contrary can be shown, the parties usually intend to create legal relations. Thus, the onus is on the plaintiff to show that legal relations were not intended.
- **What is the *Ermogenous* approach to the use of presumptions?** The question to

consider is whether, on an objective assessment, reasonable persons in the position of the parties would have understood what was intended.

- **What is a letter of comfort?** A letter of comfort is a document of assurance issued by a parent company to reassure a subsidiary company of its willingness to provide financial support or use its influence to ensure that the subsidiary meets its obligations, or to acknowledge that a subsidiary company has entered into a contract.
- **What is a voluntary agreement?** A voluntary agreement is an agreement where the parties normally don't intend to create legal relations.

Image descriptions

Figure 2 image description: Presumptions chart explaining social, family/domestic or voluntary agreements *do not* intend to create legal relations. Strong presumption parties such as commercial and business agreements *do* intend to create legal relations. Return to figure 2.

7.

CONSIDERATION

Learning objectives

On completion of this Chapter, you should be able to:

- Define consideration.
- Identify when consideration must be present.
- Explain the rules for consideration.
- Explain the distinction between past, present and future consideration.
- Explain what is promissory estoppel.

Key terms

You will notice these key terms, which are listed throughout the chapter to help you understand and remember the material:

- **Consideration:** the 'price' paid to buy the other person's promise; it must be in every simple contract.
- **Formal contract or deed**: a contract that has been signed, sealed and delivered, and does not require consideration to be valid.
- **Gratuitous promise:** a promise undertaken voluntarily and lacking consideration, so is not enforceable in court.
- **Joint promises:** where two or more persons jointly agree to provide consideration jointly and both can be sued, that is, A and B promise to pay C K100.
- **Joint and several liability:** where two or more persons agree together, as well as having made separate agreements to repay the loan individually. You then have one joint and several separate obligations, which can mean performance by one person can discharge all the others of their obligations *or* they can be sued separately. For example, A and B jointly promise to pay K100 to C **and**

separately you promise to pay K100 to C *and* B also separately promises to pay C K100.

- **Promisee:** the person who is receiving, or the recipient of, the promise
- **Promisor:** the person giving the promise
- **Several liability:** where two or more persons agree to provide consideration but each promises separately, that is, A promises to pay K50 to C and B promises to pay K50 to C.
- **Simple contract:** a contract that is made orally or in writing (or both) involving an agreement between parties with the intention of creating legally enforceable obligations and which requires consideration to be valid.
- **Variation clause:** often a clause within a contract (but can be oral) where both parties agree to change part of a contract from the way they originally agreed to while the remainder of the contract remains unchanged.

Introduction

In this chapter we begin by considering what is consideration and then look at the rules for consideration and we finish by looking the principle of promissory estoppel (an equitable remedy that provides an exception to the rule that in a simple contract there must be consideration).

In the last two chapters we looked at agreement or the offer and acceptance components of agreement (Chapter 5) and intention to create legal relations (Chapter 6). In this chapter we look at the third element needed for the creation of a simple contract: consideration.

Consideration is the last element that we need to consider for the creation of a simple contract. Remember that we need three elements to be present: agreement, intention and consideration. Also remember that at this stage, we are not considering whether what we created is a valid contract or not. We are just focusing on the creation of the contract. We deal with the question of validity in Chapters 8(capacity), 9 (consent) and 10 (legality and form).

Step 3: Consideration

The final step in determining whether a simple contract exists or not is whether there is consideration. Remember that in a simple contract, no consideration (or the 'price' you are paying for the other party's promise) means no contract. Note 'price' does not have to be money.

You will sometimes find consideration referred to ‘executed’ or ‘executory’ consideration. The former refers to the performance of an act rather than a promise of performance. Executory consideration, which is found in most contracts, consists of a promise to do something – for example, to buy and sell something.

Does consideration have to be present in a deed?

In the case of **formal contracts**such as**deeds**, there is no need for consideration becausethe contract is valid because of its form – that is, the way it is made. In the case of all other contracts, called ‘simple’ contracts, valuable consideration is requiredif the ‘agreement’ is to become a contract.

Does consideration have to be present in a simple contract?

The answer is ‘Yes’. Simple contracts must contain a bargain – only bargain promises or promises that are given because they are paid for, are enforceable.

The aim in defining consideration is to enable a distinction to be drawn between promises which are gratuitous – that is, which are freely given (such as gifts where nothing is given in return) – and those which are onerous, or ‘paid for’ by the incurring of some obligation (such as buying a video game for money, where you get the game and the seller gets the money).

What is ‘Consideration’?

Consideration is the price you pay to buy the other person’s promiseor, as Lord Dunedin said in the English case of *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*[1915] AC 847:

> *‘An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable’.*

While this is often money, don’t assume that this always must be the case. It may involve a ‘detriment’ by the promisee. (The **promisor**is the person *undertaking*the promise, while the

Video reference

This interesting online video will help you understand what consideration is. There are references to several English cases that you should take

note of as they are relevant to PNG law.

promiseeis the person who is *receiving* – or the recipient of – the promise.)

Consideration is an integral part of the bargainthat forms the basis of most contracts and it *may*be:

- money or involve a benefit given or detriment suffered as the price for the promise
- something the promisee gives to the promisor
- the carrying out of some act, or
- not doing something that the promisee had a legal right to do.

Once this condition is met, a bargain will exist.

The question of the presence of consideration rarely causes a problem at the formation stage of a commercial relationship because one party has agreed to sell goods or services to another. As a matter of fact, there will be mutual consideration present because the goods or services are being exchanged for money.

Where problems may arise in commercial arrangements is if the parties subsequently wish to change the arrangement. This can be done by the parties making a new contract (this will need new consideration to support it) or by a contract variation. clause. Variations refer to any changes made to the original terms and conditions of a contract but don't fundamentally change the contract. They are often changes that are unforeseen at the time the initial contract is entered into, such asmodifications in project scope, budget constraints, higher demand then expected for goods or services, or supply problems. Some contracts will have a variation clause written into them and they don't have to be complicated, for example, 'no variation of this Agreement shall be effective unless it is in writing and signed by both parties or their authorised representatives.' In this case, an oral variation would not be legally effective.

Variations can be initiated by either party orally, in writing or by conduct, and they usually must be agreed upon by both parties in order to be legally binding (you can have a unilateral variation if the parties agreed to that in the underlying contract). To be valid there must be agreement between the parties, consideration, compliance with the terms of the original contract, and be in accordance with the requirements of the original contract.

Business tip

Should I have a variation clause in my contract?

You can have an oral variation but be careful if it involves a large contract variation because problems can arise about the terms of the variation and there can be unforeseen consequences that were not anticipated by either party as well as documentation issues. To avoid these problems, would it be better to make a new contract? It is a good reason why you should include a termination clause in the contract to reduce the chance of being sued for breach.

General rules for consideration

In brief

Rules for consideration

Consideration **must** be present in every simple contract. Consideration:

- should be present or future, but not past
- can be anything stipulated by the promisor (even a chocolate wrapper – see the *UK case of Chappell & Co Ltd v Nestles Co Ltd* [1960] AC 87)
- must move from the promisee. In the case of joint promisees, it is sufficient consideration if it moves from one of the parties.
- must have some value, although the court is not concerned with its adequacy
- must be something more than the promise of an existing obligation (see the UK case of *Stilk v Myrick* [1809] 2 Camp 317)
- must be more than part payment of a debt (see the UK case of *Foakes v Beer* (1884) 9 App Cas 605)

- must be possible of performance
- must be definite
- must be legal but may take any form and need not be of comparable value to the promise, and
- must be referable to the other party's promise.

What is present (or executed) consideration?

Consideration is an essential element in every simple contract and can be present or futurebut **cannot be past** (this occurs where the promise is made after the act).

Present consideration is wherean act is done in return for a promise. For example, in a 'reward' situation where you lose your wallet or purse and offer a reward and someone finds the lost item and returns it for the reward, liability—that is, the payment of the reward—is outstanding on your part only. This would also be an example of a unilateral contract.

What is future (or executory) consideration?

In the case of future consideration, the parties exchange promises, each promise being consideration for the other. In this type of situation, consideration is intended to be performed in the future. For example, a sale of goods by you with payment on delivery would be an example of a bilateral contract. Here performance of the agreement remains in the future, yet a contract has been made.

What is past consideration?

In the case of past consideration, the promise is given after an act has been performed. This is generally not enforceable. For example, you purchased a horse from Amanda for K5,000 and, *after*the sale was completed, you asked her about the temperament of the horse. Amanda promised you that the horse was in good condition and not vicious, which was not true.

To be enforceable, the act (or request in this case) must be done*in reliance on the promise*. In Amanda's case above, as the contract was completed before your request, Amanda's promise is not enforceable (see the English case of *Roscola Thomas* [1842] 3 QB 234).

The rule that past consideration is not valid consideration frequently means that a promise, apparently made seriously, generally cannot be enforced by the promisee if it relates to past acts. Of course, if the promise also relates to the future, then that part of the promise will

be enforceable. For example, if you were promised higher wages, not only for the future but also for a past period when you were being paid at an agreed lower rate. Your employer later refused to honour their promise and, while they didn't have to pay you for the work already done (as that was past consideration), the promise of future wages was enforceable because you could provide consideration (as in, your labour).

Where the performance of a service and the subsequent promise to make payment for that service become part of the one transaction, this can be viewed as good consideration. For example, if you seek help from a friend and they incur K1,200 expenses in helping you and you then promise to pay them for their trouble but subsequently go back on your word, can you be sued on your promise? Were your friend's services originally performed at your request?

As a general rule in the type of situation above, the court will find that a contract existed. The request for your friend's services by you and the performance of those services, coupled with a subsequent promise to pay, were all part of the same transaction. When you made the request, there was an **implied promise**to pay something to at least cover your friend's expenses and this would suggest to the court that that you intended to create a legal relationship. The subsequent promise of the amount quantified what would be paid. This is sensible, as business is often conducted in what could be best described as an informal way.

Is a gratuitous promise enforceable?

If you promise to give a friend K100, your friend cannot enforce the contract as there is no act or promise in return. This is known as a gratuitous promise and is unenforceableunless under seal.

Must consideration move from the promisee?

While considerationmust move from the promisee, it need not move to the promisor(although in most contracts consideration will move between the two parties to the contract).

Business tip

Remember that, as a general rule, a promise made after a contract has been concluded is not enforceablebecause it is past consideration.

The person who wants to enforce a promise (the promisee) must pay for the promise or there is no contract to sue on. However, there is no need to pay for it in person; for example, payment could be through an agent appointed expressly for the purpose of making the payment or whatever other form of payment the parties agreed to.

Where a promise is made to two or more people jointly (joint promisees), and only one of those persons provides consideration, the party who has not provided the consideration can still enforce the promise because consideration is only necessary from one of the joint promisees, not from each of them.

Does consideration have to have some economic value or just be adequate?

While consideration must be valuable, it is left to the parties to decide at the time of making the agreement what is adequate. Consideration does not need to be at commercial rates, but it must have some legal or economic value even if it is a 'peppercorn' or 'token' value.

In *Chappell & Co Ltd v Nestlé Co Ltd* [1960] AC 87, an English case, Nestlé offered a music record for one shilling and sixpence plus three wrappers from its sixpenny bars of chocolate. The court had to consider whether used chocolate wrappers, which had no value, should be included as part of the consideration required for the purchase of the record for the purpose of determining what royalty Nestlé should have to pay Chappell & Co (the copyright owners). The court considered that the wrappers formed part of the consideration because without them a person could not obtain the music record. The case illustrates the court's reluctance to become involved in the question of the adequacy of value. **As long as there is something of value, the court will be satisfied.**

The question of adequacy does not concern the courts except in cases of duress. This would involve them in the task of examining every contract and trying to determine whether the price was reasonable—an impossible task. The parties may have a very good reason for establishing a particular contract price. For instance, one party may owe the other a favour, or they may be hoping to get further business as Chappel v Nestle above illustrates through a marketing promotion.

Must consideration be sufficient?

Sufficiency and *adequacy* are not the same thing. The issue of what is 'sufficient', or of a value recognised by the law as amounting to good consideration, is not always clear-cut, particularly where the plaintiff is already under an existing legal duty to the defendant. But as long as some legal value the courts can recognise, they will not be concerned about its adequacy.

Can compliance with an existing duty imposed by the law be good consideration?

The general rule is that a person cannot recover money that they have been promised in return for performance of, or a promise to perform, a duty imposed by law because there

would be no legal detriment. For example, a promise of payment to attend court when you have been subpoenaed would be a promise without consideration as you have a legal duty to attend.

An exception to this rule is where performance is beyond that which a person is legally required to do, then that would amount to good consideration.

Can repeating an existing duty owed to the promisor be good consideration?

Repeating an existing duty owed to the promisor is insufficient consideration because there is no detriment. If you are already contractually bound to the promisor to complete a task, the general rule is that in performing that task you are doing no more than you contractually agreed to do. However, acts in excess of your duty would amount to good consideration to support a new contract.

What happens if you promise to pay a lesser amount in discharge of a debt?

For example, if you owe a friend K1000, the correct way of discharging the debt is to pay the entire K1000 to your friend on the due date. However, if you come up to friend on the date and offer to pay only K750, and they accept the amount your friend can later claim the remaining K250. The implied promise is unsupported by consideration.

Can you avoid the difficulty of part-payment of a debt?

The debtor can avoid the difficulty of part-payment of a debt if they can show that the creditor requested payment of a lesser sum:

- at an earlier date than originally promised
- at a different place (for example, Melbourne instead of Sydney)
- in a different currency (for example, gold rather than legal tender) -payment by cash is not sufficiently different from that which the debtor was already obliged to do to amount to good consideration
- where they performed some other act that they were not bound by the contract to perform
- by the signing of a deed of release
- by part-payment by a third party, or
- in reliance on the defence of promissory estoppel.

In each of these situations, if a creditor accepts payment of a lesser sum in full and final settlement of their debt, they will be bound by their promise not to sue for the balance.

Can part-payment by a third-party amount to good consideration?

Where there is part-payment by a third party, the creditor (the second party) cannot claim the balance from the debtor (the first party). For example, if you (the debtor) owe your friend K1000 and a third party offers to pay your friend K500 in full settlement of your debt, your friend cannot claim the balance from you.

If your friend subsequently brings an action against you for the balance of the debt, they would fail as this would be viewed as a fraud on the third party because they had been led to believe that their part-payment of the debt would extinguish the debt.

Can forbearance to sue amount to good consideration?

Forbearance to sue can amount to good consideration.A promise not to enforce a valid claim and/or a promise to give up a claim entirely can be good consideration for a promise given in return. It is good consideration even if the promise is to forbear only for a limited period or to dispense with a doubtful, but reasonable, legal claim. The claim that is promised to be relinquished must be:

- honestly held (there must be a genuine dispute); **and**
- one in which the claimant has a bona fide belief that the liability is real at the time of agreement.

It does not matter that the plaintiff may not actually have had an enforceable claim.

Are moral promises good consideration?

Moral obligations, as well as natural love and affection, will not convert a promise into good consideration. Promises are only binding if they are part of a process of exchange. A moral obligation, or natural love and affection, is not enough. Hence the requirement of an additional factor that the courts could place a value on, however artificial that value may be.

Does consideration have to be possible of performance?

If the promise of one of the parties is a physical impossibility – for example, to walk from Port Moresby to Rabaul in a day – no real consideration would be present.

Does consideration have to be real and identifiable?

The consideration must be real and identifiable, and capable of expression in economic terms. If it is indefinite in nature or too vague to be of any value, then it will not amount to real consideration. For example, if you owed your father money and he promised you that he would waive the debt if you stopped complaining, the court would hold that the promise was too vague to be of any value and was therefore unenforceable.

Does consideration have to be legal?

Where the consideration is illegal, or a breach of public policy or the civil law, there will be no consideration.

Does consideration have to be referable to the other party's promise?

If consideration is not referable to the other party's promise, the courts will not be prepared to enforce it.

Reflection questions

You are nearly at the end of 'consideration'. Again, while you are taking a break think about the following questions on consideration.

1. Should consideration still be an essential element in a contract today? What does it achieve?
2. Explain the distinction between executed, executory and past consideration.
3. Why don't formal contracts, such as deeds, require consideration?
4. Why is past consideration no consideration?
5. Why is repeating an existing duty not good consideration?

Consider the following fact situation

FACTS: Schubert purchased a new car from Hercules Motors, and after a short time found the paintwork faulty. Hercules Motors acknowledged that something would have to be done, and it was agreed that Hercules Motors would repaint the car and restore it to 'as new' condition. It was also agreed that the work would be supervised by a paint company

representative, who would determine if the work was satisfactory. His report was unfavourable.

ISSUE: Was the promise to restore the car to 'as new' condition to avoid being sued by Schubert capable of amounting to good consideration?

DECISION: Well, what do you think?

HINT: Do you think that the defendant's belief as to the validity of the claim in these types of cases is irrelevant? Does it matter that the plaintiff's claim is in fact bad in law?

Promissory estoppel

Video reference

Law Simply Explained shares this video on promissory estoppel which provides some background on gratuitous promises before looking at promissory estoppel (just note that this video is 27 minutes long).

Promissory estoppel is an equitable remedy in contract law and it only applies where the parties were already in an existing contractual relationship and it operates when it would be inequitable for the promisor not to be held to their promise. The doctrine developed from the judgment of Denning LJ in *Central LondonProperty Trust v High Trees House Ltd* [1947] 1 KB 130. It operated where it would be inequitable, or unconscionable, for the promisor not to be held to their promise where they have made some representation about the future in relation to their conduct. The defendant had to be able to show that they relied on the plaintiff's promise and changed their positions accordingly, so that they would now suffer serious loss if the plaintiff was allowed to return to their original contractual position. But did you note that it was a defence for a defendant?

In Australia, the High Court in *Walton Stores (Interstate) Ltd v Maher* [1988] HCA 7 decided that held that promissory estoppel could also be used to commence an action.

When is promissory estoppel important?

The rule that there must be consideration present in every simple contract if it is to be valid has sometimes allowed a person to break an agreement and leave the injured party with no remedy. The principle of promissory estoppel may provide relief to an innocent

party by preventing a party from going back on their word where they have made some representation about the future in relation to their conduct. It is essentially an estoppel about future conduct.

The aim of the innocent party is to avoid the detriment generated by the person who has gone back on their promise or denied the truth of a representation. In this case, the only way to achieve an equitable outcome was to enforce the assumed contract, despite the absence of a concluded agreement.

In brief

A promissory estoppel:

- operates as both a defence or shield for a promisee.
- can apply even in the absence of pre-contractual obligations.
- does away with the requirement that consideration is required in simple contracts and that it must move from the party suing to the party being sued.

Business tip

Avoiding the operation of the doctrine of promissory estoppel.

Application of the doctrine is really limited to only a suspension of the promisor's rights, not a termination of them. The promisor can withdraw the promise if reasonable notice is given to that effect to the promisee, and it is possible for a return to the position that the promisee occupied before the suspension of the promisor's rights.

Key points

An understanding of the following points will help you to better revise material in this Chapter relating to consideration.

- **What is meant by 'consideration'?** Consideration is the price you pay to buy the other person's promise. It is what the promisor gives in exchange for the return promise.
- **When does consideration have to be present in a contract?** Consideration must be present in every simple contract. It must not be past and must move from the promisor.
- **What are the rules for consideration?** Consideration must be present in every simple contract. It must:
  - be present or future, but not past
  - be anything stipulated by the promisor
  - move from the promisee. In the case of joint promisees, it is sufficient consideration if it moves from one of the parties.
  - have some value, although the court is not concerned with its adequacy
  - be something more than the promise of an existing obligation
  - be more than part payment of a debt
  - be possible of performance
  - be definite
  - be legal but may take any form and need not be of comparable value to the promise, and
  - be referable to the other party's promise.
- **What is the distinction between past, present and future consideration?**
  - **Present (executed) consideration** involves an act being done in return for a promise.
  - **Future (executory) consideration** involves the parties' exchanging promises, each promise being consideration for the other. In this type of situation, consideration is intended to be performed in the future.
  - **Past consideration** involves the giving of a promise after an act has been performed and is generally not enforceable. The act must be done in reliance on the promise.
- **What does variation of a contract mean?** If a party, or both parties, wish to change their contract this can be done by the parties making a new contract (this will need new consideration to support it) or by a contract variation. clause. Variations refer to any changes made to the original terms and conditions of a contract but don't

fundamentally change the contract and are changes that are unforeseen at the time the initial contract is entered into. They can be oral changes but are better to be in writing to limit or avoid potential problems arising.

- **What is 'promissory estoppel'?**Promissory estoppel will allow a promise to be enforced even though the promisee has not provided consideration for that promise. It operates where it would be inequitable, or unconscionable, for the promisor not to be held to their promise. It may be used as a defence or to initiate a cause of action if the promisee's position has been altered in reliance of the promise.

8.

CAPACITY OF THE PARTIES

Learning objectives

By the end of this chapter, you should be able to:

- Explain the common law rules regarding contracts entered into by minors (infants).
- Outline the common law rules regarding capacity to contract corporations, the mentally ill and those under the influence of alcohol.

Key Terms

You will notice these key terms, which are mentioned throughout the chapter, to help you to better understand and remember the material:

- **Beneficial contracts of service:** contracts that are for the minor's benefit and are not oppressive, including employment, education, apprenticeship and training contracts.
- **Corporation:** a legal entity (also known as a legal person) created by the *Corporations Act 2001* (Cth); also known as a 'company'.
- **Infant:** a person under the age of 18 years; also known as a 'minor'.
- **Necessaries:** goods or services that are reasonably necessary to the 'station in life' of an infant and their actual requirements (defined in the *Goods Act 1951*, s 4).
- **Void:** of no legal effect.
- **Voidable:** an agreement that may be affirmed or rejected at the option of one of the parties.

Introduction

In this, and the next two chapters on consent and legality, we look whether the contract that you created is valid, voidable, void or unenforceable. In other words, is the contract you created (or working with, valid?) This chapter will also introduce you to the rules regarding the capacity of the parties to a contract and whether they fully understand the terms and conditions of the contract. Under both common law and statute law there are certain types of people who are considered to be incapable, either partly or completely, of understanding the rules and obligations associated with them entering into a contract. However, this is not the end of the story. You still need to know whether there is real consent to the contract by one or both of the parties (Chapter 9) and whether the purpose of the contract is legal (Chapter 10) before you can say with any confidence that the contract is valid. And even though we might have a valid contract, don't assume that is the end of contract law because problems can still arise as to exactly what have the parties agreed to (Chapter 11) and what happens if one of the parties doesn't comply the terms of the contract, in other words, they breach the contract (Chapter 12).

Step 4: Capacity to contract

Do the parties to the contract have full contractual capacity?

Only a normal, sane, sober adult person (s 17 of the *Companies Act 1997* gives a company the same legal capacity as an 'individual' until it is deregistered) has full capacity to make a contract. Only adult persons, as in, those persons over the age of 18 have the capacity or ability to understand what it is they are entering into.
Under common law (and in some cases statute law such as s 3 of the *Goods Act 1951*but **not**the *Infants Act 1956* as that deals only with guardianship and custody of infants), some classes of people, such as infants, those with mental incapacity, and intoxicated persons,are treated as not having that ability to understand fully what it is they are entering into. Necessaries aside, this can affect the validity of any contracts that may involve them because, if you think about it, even though there may be an agreement, is that agreement a fair bargain if the individual doesn't understand what it is that they are getting into?

Having capacity is more than just having the ability to sign the contract. You need to consider a number of factors concerning the party you are dealing with including:

- Do they understand all the facts?
- Do they understand what their rights and obligations are?

- Are they able to weigh up those rights and obligations in coming to a decision?
- Do they understand the consequences of the choices they make?

So who are infants (or minors) in PNG?

The *Constitution* and Organic Law provides for full contractual capacity from the age of 18 years. This does not mean that an infant, as in, someone under the age of 18 cannot enter into contracts. They can and the law will offer protection to them from exploitation.

For example, in the case of an infant getting a job, there is an employment contract between the infant and the employer (*see*,for example, the *Employment Act 1978* which prohibits the employment of children under 11) which provides that children between 11 and 16 can be employed as long as the employment doesn't interfere with school attendance, they have parental permission and the infant gets paid for their services.

Online reference

If you are interested in the employment of young persons and what the *Employment Act 1978* says about terms of employment (s 103), working under injurious conditions (s 104) or hours of employment (s 105) see sections 103 – 105 of the *Employment Act 1978*.

Classification of contracts for infants

Insofar as an infantis concerned, whether the contract is **valid**, voidableor voidwill depend on what the contract is about.

What is a valid contract for an infant?

The general rule at common law is that a contract made by an infant is voidable except in two instances (where it is valid and binding on both parties):

- contracts for necessaries
- beneficial contracts of service.

What are contracts for necessaries?

The**definition of necessaries includes articles and services essential for the reasonable comfort of the infant, as well as basic food, medicine, education, clothing and shelter**. Goods supplied to the married infant's family, and goods supplied in contemplation of marriage, are also regarded as necessariesat common law. This means that lifestyle and the infant's situation must be considered when trying to determine whether the goods or services are capable of being necessaries or not and the transaction may be caught under s 4 of the *Fairness of Transactions Act 1993* if the contract is unfair.

Section 4 of the *Good Act 1951* defines necessaries as goods suitable to the condition in life of a person (including an infant) and to their actual requirements at the time of sale and delivery. In other words, the lifestyle and situation of the person or infant will determine what are necessaries.

To successfully sue an infant, a business (the plaintiff) **must**be able to establish two factors.

- Are the unpaid goods or services capable of being necessaries? The court has to first be satisfied that, in the circumstances, the goods or services are capable of being a necessary, and this is a question of law. The onus is on the plaintiff to prove that they are, and, if they fail, the case is dismissed. If the goods or services are capable of being considered to be a necessary for the infant, then the plaintiff needs to go on and establish the second point.
- Are the goods or services necessaries at the time of sale and delivery?This is a **question of fact**. Look at the actual requirements of the infant and decide whether the infant was adequately supplied with these goods or services at the time of sale or delivery. It may be necessary here to consider the social standing of the infant, their occupation, social conditions, whether they were already adequately supplied and other similar factors.

There seems to be no reason why services cannot also amount to necessaries if it can be established that the contract is beneficial to, or a necessary service for, the infant – for example, paying for tuition that the infant could subsequently use to obtain employment.

Even if a trader establishes that a contract with an infant is for the supply of goods or services that amount to necessaries, the contract can still be void if it contains harsh or onerous terms under s 4 of the *Fairness of Transactions Act 1993.* **The contract must, on balance, be fair.** Note the words 'on balance' because they suggest that the law recognises that a contract can contain unreasonable terms without being invalid. There has to be a

balance. If it is, the infant will be bound to pay but only a **reasonable price for the goods** under s 4(3) of the *Goods Act 1951*.

Business tip

Should I sell goods or provide services to an infant on credit?

There is considerable risk for a trader to sell goods or services to an infant on credit. If the infant is already well supplied with those articles or services, then the supplier would not only be unable to enforce payment, but in the case of goods they may not be able to recover them (unless the goods were obtained by fraud). If the supplier hopes to be able to enforce the contract, they must ensure that:

- the goods or services are capable of being, **and** are, necessaries
- the contract does not contain any harsh or onerous terms; **and**
- the price is reasonable.

What is a beneficial contracts of service?

Beneficial contracts of serviceare the second exception to the non-enforceability rule of a contract entered into by an infant at common law and there is limited protection under legislation (for example, ss. 79-80 of the *Child Welfare Act 1961*, the *Lukautim Pikinini (Child) Act 2015*, and ss 103-105 of the *Employment Act 1978*).

Beneficial contracts of employment are contracts of employment, apprenticeship, training or education and can contain unfavourable terms but this does not necessarily mean the contract will automatically be declared void. In these types of cases, the court will:

- examine the contract as a whole
- weigh the onerous (harsh) terms against the beneficial terms, **and**
- decide, looking at the contract as a whole, whether the balance is in favour of the infant.

Reflection question

Let's test your understanding of what is a fair contract of employment for an infant.

FACTS: The defendant, while still an infant, had entered into an article clerkship with the plaintiff to become a solicitor. One of the terms in the agreement was that the defendant would not practise as a solicitor within 200 kilometres of Port Morseby, where the plaintiff had his practice. A year after the defendant had finished his articles, he commenced practice in Lae and the plaintiff sought an injunction to stop him.

ISSUE: Do you think the clause was so onerous that it outweighed the beneficial terms and that therefore the contract was not valid?

DECISION: So, what do you think?

COMMENT: Look at the question from both points of view, as in, the infant and the employer. Also think about whether something like s 4 of the *Fairness of Transaction Act 1993* could apply here.

Where the contract is for employment, instruction or education of the infant, it will generally be treated as binding by the courts as long as it is possible to identify that it provides, on balance, benefits to the infant.

While benefit is the basis for the validity of this type of contract, this does not mean that any contract that the infant enters into and obtains benefits from will be automatically enforced against the infant. Thus, a trading contract such as a loan agreement with a finance company may result in financial benefit to the infant but it may not be binding.

What types of contract are valid unless voided by an infant?

The class of contracts involved is limited to those through which the infant acquires an interest in some subject matter of a **permanent and continuous** nature. For example, purchase of shares in a company and partnerships. The contractual obligation then remains until the infant decides to put an end to it.

When an infant repudiates (rejects or ends) a voidable contract during infancy or within a**reasonable time**after becoming an adult (and w**hat constitutes a 'reasonable time' depends on the circumstances in each case**), under the common law the rights and liabilities that accrue after repudiation cease. **The infant will remain liable for any obligations accrued up to the time of repudiation of the contract unless there has been a total failure of consideration.**

Money already paid by an infant under a voidable contract is irrecoverable unless the infant has received no benefit from the contract whatsoever – that is, there has been a total failure of consideration. However, no matter what the subject may be, the courts are reluctant to find that the infant has received no benefit.

Does a corporation have the capacity to contract?

Contracts can be made by both 'natural persons' and 'legal persons'. The latter are a creation of the law but are treated by the law as having the complete legal capacity of a natural person – for example, corporations.

In corporation under the *Companies Act 1997* s 16 gives a company a **separate legal existence**from that of its members. It should be **viewed as an 'independent person' with its own rights and liabilities.** As such, its contractual capacity is limited only by natural impossibility when it comes to entering into personal contracts because it is an artificial creation.

The fact that an act is not in the best interests of a company does not affect the capacity of the company to do the act (s 18(3)). Under s 155, a company may be bound by contracts (including deeds) entered into by its agents acting on behalf of the company with express or implied authority.

Do bankrupts have the capacity to contract?

Bankruptcy is a legal process that can occur when an individual cannot pay their debts as and when they fall due. The process is governed by the *Insolvency Act 1951*.

A person can become bankrupt voluntarily while owing any amount – a **debtor's petition**. However, creditors cannot make a person bankrupt unless the debt they are owed is K100 to one creditor, K140 to two creditors or three or more creditors K200 or more (s 25(2))(a creditor's petition).

As a general rule, bankruptscan still contract, but **their contractual capacity is limited**during the period of bankruptcy (which will normally last for three years: ss 131(c),

134(1)). A director cannot hold their position on a company Board while bankrupt(*Companies Act 1997*, Sch 5.3(a1))

Do mentally unsound and intoxicated persons have the capacity to contract?

Contracts with the mentally unsound or the intoxicated are usually regarded as being **voidable**at the option of that person unless they are for necessaries. The *Goods Act 1951,* s 4(3) requires that mentally unsound and intoxicated persons who purchase goods that are necessaries must pay a reasonable price for them.

The *Goods Act 1951* is silent where the goods are not necessaries. Under the common law the person suffering the disability **may**be able to repudiate the contract when they are again of sound mind or sober, if at the time of contracting:

- they were suffering from such a degree of mental instability or were so inebriated that they were incapable of understanding the nature of the contract; **and**
- this was known, or ought to have been known, by the other party.

The **onus of proof**lies on the person wishing to repudiate the contract and must occur within a reasonable time of regaining sobriety or soundness of mind. But it should also be noted that it is not easy to have a contract set aside unless the lack of capacity was known or was readily**observable at the time of contracting.**

Reflection questions

Well done. You have reached the end of another chapter. Here are some more reflection questions to test your understanding of what you have read. Don't forget to make notes of your answers as it will help you with your revision at the end of the Unit.

1. Discuss how a court decides whether goods or services purchased by an infant will result in a valid contract.
2. Samantha, an infant, obtained a loan of money from Lucy by telling her that she was 19 when in fact she was only 16. Samantha subsequently defaulted on the loan

repayments and Lucy wants to know whether she can recover her money. Advise Lucy.

3. Ryan, a 78 year old alcoholic who, during a drinking session with Bromley, was induced to sell his farm to him for much less than its market value. A written contract was drawn up at the Bar and signed by both parties. Ryan later refused to go through with the sale. Is the contract that Ryan signed enforceable by Bromley? Explain.
4. Steinberg, a minor, applied for and was allotted shares in a company when she was 16. She received no dividends and attended no company meetings. Before she turned 18 she repudiated the contract and tried to recover the money she had paid for the shares. Can she recover the money? Explain why?

Key points

An understanding of the following points will help you to better revise material on capacity.

- **What are the common law rules regarding contracts entered into by infants, and when are such contracts valid, voidable or void?**Contracts entered into by infants at common law are regarded as either:
  - **valid** (if it can be established that they are for necessaries or beneficial contracts of service and that the price is reasonable)
  - **voidable** (binding unless repudiated by the infant and involving the acquisition of an interest in property of a permanent nature or a continuing obligation), or
  - **void** (they do bind the other party and cover purchases of non-necessaries and trading contracts, but are not binding unless ratified by the minor after attaining majority).
- **What are the common law rules with regard to capacity to contract with respect to the following?**
  - **Corporations.**A company is an artificially created legal person, but has the capacity of a natural person. The contractual capacity of a corporation is exercised through individuals who have the company's express or implied authority and are acting on behalf of the company.
  - **The mentally ill and those under the influence of alcohol.**If a person who was mentally ill or intoxicated at the time of contracting can establish that they did not understand what they were doing and that the other person was aware of their

disability, the contract (which is voidable) can be set aside at the option of the mentally ill or intoxicated person when they become mentally sound or sober.

9.

GENUINE CONSENT

Learning objectives

On completion of this Chapter, you should be able to:

- explain the effect of a mistake on a contract
- explain the different types of mistakes
- explain the effect of a mistake on a written document and the effect of the operation of the legal doctrine of *non est factum*
- distinguish between innocent and fraudulent misrepresentation and describe their effects on a contract
- explain what is required to amount to a negligent misrepresentation
- explain the meaning of the terms ‘duress’ and ‘undue influence’, and describe their effects on a contract
- explain what unconscionable conduct is and its effect on a contract.

Key terms

You will notice these key terms, which are mentioned throughout the chapter, to help you to better understand and remember the material:

- **Collateral contract:** a separate or subsidiary contract to the main contract, which may be verbal or written, and which exists independently of the main contract (that is, it is not a term of the main contract
- **Common mistake:** both parties are mistaken as to existence or identity of the subject matter
- **Duress:** threats of, or use of, force that deprives the innocent party of exercising their free will
- **Misrepresentation:** a false statement of fact, which may be intentionally or unintentionally made

- **Mutual mistake:** where both parties to a contract are mistaken, but about different things
- ***Non est factum:*** 'not my doing' or 'not my deed'; where a party under a disability is mistaken about the very nature of a document that they are signing, believing it to be one thing when in fact it is something quite different
- **Rescission:** the reversal of a transaction which restores both parties back to their original positions
- **Representation:** a statement of fact
- **Restitution:** an equitable remedy available for the unjust enrichment of the defendant at the plaintiff's expense
- **Unconscionable contract:** an unfair or unjust contract
- **Undue influence:** the improper use of power
- **Unilateral mistake:** where one party is mistaken about some aspect of the contract, but the other party is not.

Introduction

In the last chapter we looked at the capacity of you and the other party to see whether you understood both the rules and obligations associated with entering into a contract. In this chapter we are going to look at exactly what it is that you would have consented to when entering into a contract.
The basis of a contract is agreement or consensus ad idem(a meeting of the minds). In this chapter we are looking at what happens if you or the other party has:

- made a mistake
- made a misrepresentation
- used duress (force)
- undue influence, or
- displayed unconscionable conduct,

then there is there is no genuine consent. Thus, the fifth question (or Step 5) we have to consider is: Is there genuine consent between the parties? What have you and the other party agreed to?

Step 5: Is there genuine consent?

If you are satisfied that there is no problem with the ability of you and the other party to fully

understand what you are entering into (as in, the question of capacity), then you can move on and consider whether there is genuine consent between you and the other party.

what have the parties consented to?

If the contract has been entered into because of a mistake by you or the other party, or because one of you may have a superior bargaining position and has made a misrepresentation or used duress (force), undue influence or unconscionable conduct to get an 'agreement', then there is no genuine consent and therefore no valid contract.

The question you must ask yourself when considering the question of consent is: **Was the consent between us genuine? Is this what we have agreed to?**

What is mistake?

So, let us begin with mistake. If you or the other party says that they have misunderstood the situation, or they have made a mistake, has an agreement been reached or not? As a general rule, if the parties*appear*to have reached an agreement, the law *assumes* that they have in fact reached agreement.

The law is reluctant to accept a mistake as grounds for voiding a contract as it would provide an easy way out for a dissatisfied party to get out of an agreement and it would also seriously undermine the certainty and reliability essential to commercial transactions. So, what is the effect on the contracting parties if there is a mistake?

What is the effect of mistake on the contracting parties?

Where a mistake does operate, and the mistake is serious, one outcome is to make the whole transaction null and void from the very beginning (they call that *void ab initio*). This would put you and the other party in the same position as if no contract had ever been made. However, if the mistake is trivial or does not go to the main purpose of the contract, it may still be enforceable.

What is effect of mistake on third parties?

While you and the other party may not be concerned about being restored to your original positions, innocent third parties may not feel the same way. Suppose you sell your car to John who pays you by cheque, which is subsequently dishonoured. You want your car back, but John has already sold it to Liz, a third party. You track down Liz and the question you have to consider is whether you can recover your car from Liz or the money from John.

If the original contract between you and John is now declared void for mistake, he has no title to ownership of the car and therefore cannot pass good title on to Liz. The contract is void from the beginning (or void *ab initio*) and the title to the car will remain vested in you. Liz, who is a third party, would be required at common law either to return the car to you or pay you, its value. Liz's right to sue John is generally limited because he is not going to hang around and disappears. It is because of this kind of injustice that the courts place such stringent limitations on the operation of mistake. The question for the courts is, who is going to be the loser because there has to be one. It is going to be either you or Liz.

Business tip

Neveraccept a cheque from a buyer unless it is a bank cheque or if you do, wait until the cheque is cleared before you give them the item they have agreed to buy.

What is mistake of fact?

Two principles are clear:

- Only **mistakes of fact**can render a contract **void**. If one of the parties makes a mistake of law (for example, wrongly interpreting a statute), a mistake of judgement (for example, buying clothes and then not liking the style or colour) or a mistake as to quality, then that party generally cannot rely on the mistake to avoid the contract. However, money paid under a mistake of law *may* be recoverable.
- There are very few mistakes of fact that provide grounds on which courts can invalidate a contract.

In brief

Basic types of mistakes of fact

TYPE OF MISTAKE	DESCRIPTION	EFFECT
Common mistake (rarely arises in practice) for example, buying a painting that you and the seller believe is an original when it is not	Both parties are mistaken about the same thing	Rarely a remedy at common law but may be in equity in rescission or rectification
Mutual mistake (rarely arises in practice) for example, where you think you are buying B's 2023 Ford Ranger when they think you are buying his 2020 his 2021 Ford Ranger.	A mistake made by both parties but about different things, so no genuine agreement	Contract void
Unilateral mistake (more common) for example, where you are contracting with B, who you never intended to deal with because you thought they were C	Only one party is mistaken about a material fact regarding the subject matter of the contract, so no genuine agreement	Remedy usually in equity in rescission or rectification. Contract may be void or voidable
Non est factum—it is not my deed (occurs only rarely) for example, if you were illiterate and could speak little English and you signed a document believing it to be a receipt when in fact it was option to purchase your house.	Signatory did not understand the nature of the agreement they signed, so no genuine agreement	Contract void

What is the difference between common mistake, mutual mistake, unilateral mistake and *non est factum*?

In the event of common mistake, there is a *genuine agreement*between the parties as they are both agreed on the same matters. The offer and acceptance have corresponded, and the parties are of one mind. However, owing to a common error as to some fundamental fact, the agreement may have no legal effect. In the case of mutual mistake, unilateral mistakeand *non est factum*, there is *no genuine agreement*, as there is no real correspondence of offer and acceptance.

What is common mistake?

In the case of a common mistake, the parties acknowledge the existence of an agreement (for that is admitted) but, because of a fundamental assumption as to the existence or identity of the subject matter, they wish the court to set the agreement aside from the beginning. In other words, the parties are asking the court to treat the agreement as having no legal effect and for any money or property that the parties have paid or conveyed to each other in reliance on that agreement to be recovered.

The courts have generally been reluctant to void contracts in which the common mistake involves accidental qualities or attributes of the subject matter. For example, you purchase a

painting that you and the seller believe has been painted by a famous painter. However, you later discover when you go to sell the painting that it is counterfeit and virtually worthless. Can you rescind the contract and get back your purchase price from the seller?

Because there was no error as to what you were given, what you have is a common mistake. You and the seller were agreed on the same terms on the same subject matter, and that is sufficient to make a contract.

Mistake as to the existence of subject matter. A common mistake must involve the existence or identity of the contract's subject matter. If you and the other party were both mistaken, the transaction will be void from the beginning because of the absence of the thing on which the contract was based. In each case it is a matter of construction. A common mistake as to the quality, nature or value of the contract is not enough to render the contract void from the outset.

Reflection question

Take a break for a couple of minutes and think about this real-life fact situation.

FACTS: The Commission advertised for tenders for the purchase and salvage of an oil tanker:

> *Tenders are invited for the purchase of an oil tanker lying on Jourmaund Reef, which is approximately 100 km North of PNG. The vessel is said to contain oil. Offers to purchase the vessel and its contents should be submitted to the PNG Disposals Commission and should be lodged not later than 2pm March 31, 2024.*

You decided to tender for it and were successful based on information provided by the Commission as to where to find the tanker.

You hired a ship, fitted it out and proceeded to the location given by the Commission. After a month of searching, no luck. Not surprising because there was never any tanker lying at or near the location given by the Commission.

ISSUE: Has the Commission made an implied promise of the existence of the tanker? Have you acted in reliance of that promise to your detriment? Is the Commission bound?

DECISION: What do you think?

Where the contract is for the sale of specific goods which have perished at the time the contract is made, the *Goods Act 1951* provides that 'where there is a contract for the sale of specific goods, and the goods, without the knowledge of the seller, have perished at the time when the contract was made, the contract is void' (*Goods Act 1951*, s 8(1)). Thus, if you sell your car to a friend, and unknown to you the car caught fire and was burnt out an hour before the sale, the contract would be void and there would be no liabilities incurred on either side (*Goods Act 1951*, s 8(2)).

Mistake in equity maygive relief where the mistake involves the quality or attributes of the subject matter. Here, the court may treat the contract as voidable, however, as the remedy is being sought in equity, it is a discretionary remedy. It is also worth noting that neither you nor the other party can rely on their own mistake to say that the contract was a nullity from the outset.

What is mutual mistake?

In the case of mutual mistake, as the parties are talking about differentthings, there is no real agreement between them. For example, you decide to buy your friend's car. However, you think you are buying his 2023 Toyota Corolla, but he thinks you are buying his 2023 Toyota Camry. Here you and the other party are talking about the same manufacturer but different models. Each of you is unaware of the error and are mutually mistaken as to the other party's intention. In other words, the offer and acceptance do not correspond and so the contract is *void ab initio*.

Where mutual mistake has been pleaded, the courts apply an **objective test**of the reasonable person to the words or conduct of the parties to determine whether or not any agreement has been reached or whether you and the other party are at cross-purposes.

Reflection questions

Take a quick break and think about these two questions.

1. Explain why money paid under a mistake of law may be recoverable while a party who makes a mistake wrongly interpreting a statute, or a mistake of judgment (for example,

buying clothes and then not liking the style or colour) or a mistake as to quality, generally cannot rely on the mistake to avoid the contract.

2. You were in London when you received an order from a Middle East agent for 'Moroccan horsebeans described here as feveroles'. Not knowing what the term meant, you asked the defendants, who replied that feveroles were the same as horsebeans, which they were in a position to supply. The plaintiffs then ordered a quantity of horsebeans from the defendants and the goods so described in the written sale document that was drawn up were delivered to the plaintiffs, who in turn shipped them to Egypt. When they reached Egypt, the plaintiffs refused to accept them since they were not feveroles. Had the plaintiffs any cause of action against the defendants?

What is unilateral mistake?

Like mutual mistake, there is a lack of agreement between the parties. However, here only one party to the contract knows, or ought to be reasonably aware, of the mistake and does nothing to correct it.Such cases usually involve a mistake as to the identity of the parties to the contract, and while the majority of cases concern fraud, it should not be assumed that this is the only way unilateral mistake operates.

A mistake of this type can arise, for example, when A contracts with B, believing B to be C. In the English case of *Boulton v Jones* (1857) 157 ER 232 ('*Boulton v Jones*'), it was Jones' intention to contract with Brocklehurst and no one else, as Brocklehurst owed him money. But unknown to Jones, Brocklehurst had sold his business to Boulton. When Jones sent a written order for goods expressly addressed to Brocklehurst, Boulton struck out Brocklehurst's name and substituted his own and then completed the order. He did not tell Jones of the change of ownership. When he asked for payment, Jones refused to pay, arguing he never intended to contract with Boulton because he had a set-off with Brocklehurst on which he intended to rely. As Jones had no intention of contracting with Boulton, and Boulton knew this but assumed it didn't matter, there was no contract.

In such a situation there is no correspondence between offer and acceptance, and the agreement can be avoided. Because the courts will not generally declare a contract void from the outset (or void ab initio) for unilateral mistake under the common law, the mistaken party will generally seek an equitable remedy of either rescissionor rectification. In a case like Boulton v Jones, the court in its equitable jurisdiction will generally require some improper conduct before granting equitable relief. In Boulton's case, Boulton knew that Jones had no intention of contracting with him but did nothing about it.

What happens where the parties meet face to face?

Where the parties meet face to face, it is assumed that a contract was concluded between the parties because the offer was accepted by the person to whom it was directed. The onus of rebutting the presumption lies on the party pleading the mistake of identity. They have to show **all three** elements:

- they intended to deal with C and no one else—personal identity is vital
- they never intended to deal with B, and to this end they took reasonable precautions to check B's identity; **and**
- B knew that they never intended to deal with anyone but C.

The courts will allow an action for unilateral mistake to succeed and treat the contract as void. However, if the intention is to deal with the offering party, whoever they might be, then the contract can only be treated as voidable.

Business tip

Where the parties meet face-to-face and there is a third-party involved, if you are the plaintiff you are going to have to show that identity is crucial to completion of the contract or the courts will treat it as voidable, which generally results in the third-party getting title.

Where the distinction becomes important is when an innocent third party becomes involved because, because if you are the injured party until you rescind, the contract is valid and binding.This means that if a swindler can sell the goods before you rescind and the third party is a purchaser for value and in good faith, the third party will get good title and you will be left with the problem of finding the swindler if you want to get your money back. Good luck with that. So, the**question of personal identity is vital**.

The questions the court will consider in this type of situation are:

- who did you intend to contract with? The person standing in front of you or someone else? **and** also,
- did you take sufficient steps to check the identity of the person in front of you?

The rights of an innocent third party will prevail if they can establish that they acquired rights in the goods before you were able to rebut the presumption that you had not intended to deal with the person in front of you.

The importance of unilateral mistake is that it makes the contract void ab initio(void from the

beginning). This means that a third party cannot get good title to your goods and you can recover them from whoever has possession. The third party then has to try and recover their money from the swindler. Actual knowledge of the mistake is not necessary.It is enough if the party who is not mistaken ought to have known, or strongly suspected, that you had made a mistake of a fundamental character.

Business tip

When buying or selling goods always check the identity of any party with whom you are dealing. Do not rely on what they say, do not rely on who they say they are and do not hand over any goods until you have taken all reasonable steps to identify the person with whom you are dealing. If you are the seller, this means getting the 'cash' before handing over the goods. If you are the buyer, it means making sure that you get title with the goods when you hand over the money. Check the *Personal Property Security Act 2011* in the Personal Property Security Registry to see if the goods are registered and if they are, you will not get a good title. So, keep copies of all documents.

What is *non est factum*?

Sometimes a person will sign a document and later discover that what they signed is fundamentally different from what they thought it was. Where this occurs, the party who signs the document knowing that it contains contractual terms will generally be bound by those terms, whether they have read them or not. If they want to avoid the contract, the signing party would have to argue that the agreement was voidbecause it was radically different from what they thought it was. This is the defence of *non est factum*, which means it is 'not my doing' or 'not my deed'.

To succeed in a plea of *non est factum*, *two* conditions must be met:

Online reference

The *Personal Property Security Act 2011* is a very important Act as it impacts on virtually all commercial transactions in PNG, whether by corporations or individuals. The Act applies to almost all types of property other than land including

physical assets and intangible property by creating a security interest, which is 'a legal interest in personal property that secures payment or performance of an obligation'.

- the person must believe that the document they signed is radically different from what they believed it to be—the mistake must go to the fundamental nature of the document and not its contents; **and**
- there must be an absence of carelessness or negligence in the execution of the document.

There is a heavy onus of proof on the person raising the defence, especially if a third party is involved. They have to establish that they acted carefully. It follows that if a party signs a document leaving blanks to be filled in by a third party, the plea of non est factum would be unavailable owing to the carelessness of the signer.

Signing without reading the document does not prevent the defence of *non estfactum* from being raised. However, the classes of persons that can raise the defence are limited to two groups:

- those who are unable to read owing to blindness, illiteracy or a congenital intellectual impairment and who must rely on others for advice about what they are signing; **and**
- those who, through no fault of their own, are unable to understand the meaning of a particular document.

Even if the plea of *non estfactum* is unsuccessful, there is generally an element of fraud or undue influenceinvolved which would make the contract voidable. As long as there are no innocent third parties involved, the injured party will still be able to avoid the contract.

What is the effect of mistake on a contract?

The effect of mistake, with the exception of unilateral mistake as to a term of the contract, will depend on the remedy that you, if you are the plaintiff, are seeking. Remedies include:

- **at common law:** declaring the contract void ab initio (from the beginning) if the mistake affects the very existence of the contract (which means neither party can enforce the contract), an action in rescission to recover any money paid (if the contract is yet to be performed), or the tort of conversion (if the agreement has been performed)
- **in equity:** rescission (cancellation), restitution (unjust enrichment unless there are third-party rights), rectification (if the terms of the contract have been incorrectly written down), or specific performance, and
- **by statute:** under the *Fairness of Transactions Act 1993*.

Reflection questions

Take another quick break and think about these three questions.

1. Buka has a very poor understanding of English. When you approached him with a document for his signature, Buka was under the honest and mistaken belief that what he was to sign was only a letter of introduction to his agent. What he in fact signed was a lease of his shop premises to you —which at no time did Buka intend or want to do. You are now suing for specific performance (to force him to give you his shop) and damages for breach of contract. Advise Buka.

2. Explain why you would prefer to base a case on unilateral mistake rather than common mistake or mutual mistake, if there is a third party involved.

3. You own the Gold Star jewellery shop in Port Moresby. A well-dressed customer comes in one Friday lunch time and asked to look at some jewellery as a present for his wife. He selects a number of items, which add up to K59,750, and offered to pay you by cheque. He explained he would have used his debit card but it was damaged in a recent flood, and he is now waiting for a replacement from the bank. He told you he is Mr Wayne Bruce MP, sitting member for the seat of Rabaul, and gives you an address. As he was signing the cheque, he offered as a sign of good faith, to take half now and collect the other half when the cheque was cleared. You check online and finding details of Bruce, you take the cheque. Later that afternoon, Bruce pawned the jewellery to Brooks, a pawnbroker, for cash. When the cheque was dishonoured, you tried to recover the jewellery from Brooks.

- Is there a contract between you and Bruce? Explain why/why not.
- Do you think you have done enough to check on the identity of Bruce?

What is misrepresentation?

The apparent consent of the parties can be affected if it is subsequently found that one party has misrepresented the facts to the other. If you, as the plaintiff, can establish that the other party has made a false or misleading statement of fact which has induced you to enter into a contract, this is called a misrepresentation. The misrepresentation can be fraudulent,

innocent, or negligent and can be made orally, in writing, by silence or by conduct. The remedies available to an injured party will depend on the type of misrepresentation.

Business tip

It is important, if the transaction you are entering into is of value to you, that you do your homework before the transaction is to take place. That means that you and the other party should attempt to obtain all the information relevant to the contract. This is often difficult, and so it becomes necessary to rely on the representations, promises and conduct of the other party. But if things go wrong, you must be able to demonstrate to the court that you have taken all reasonable steps to ensure that the transaction can go ahead.

What is a representation?

A representationis a statement of past or present factmade by one party either before or at the time of making the contract that induces the other party to enter into the contract. If the representation is untrue, then it is called a *misrepresentation*, which, depending on the circumstances, can be:

- fraudulent
- innocent, or
- negligent.

Note that the three different forms of misrepresentation provide the injured party with different remedies, so it is important to understand the difference between each action.

The following are generally not considered to be representationsand therefore donot form part of the contract:

- statements of law
- statements as to future conduct or intention, unless the party making the statement has no intention, or there are no reasonable prospects, of fulfilling it
- statements of opinion – for example, if you say that the value of your car is K40,000 when it is only worth K25,000, then you are stating an opinion, but if you said you paid K10,000 for it when you only paid K5000 then that is a misrepresentation because you are falsely stating a fact
- statements of a highly exaggerated nature (example, advertising puffery)
- silence or non-disclosure if it creates a false impression.

No action is available for breach of contract because they are not part of the contract,

although there may, depending on the circumstances, be an action in tort for negligence or deceit, or an action under the*Fairness of Transactions Act 1993* based on unfairness.

Representations forming part of the contract are known as **terms**and if they turn out to be untrue (as in, they are misrepresentations) the innocent party may be able to rescind the contract and/or be able to recover damages. More on that in Chapter 11.

It is not necessary for the representation to be made directly to you if you are the injured party as long as it is made with the intention that it should be acted on by you –that is, it must produce a misunderstanding and be one of the reasons for you to enter into the contract. If you had knowledge of the untruth of a representation before the contract was entered into or signed, it is not possible to assert that the statement has misled you and any right to relief for you would be lost.

What types of misrepresentation are there?

In brief

Types of misrepresentation

TYPE	DESCRIPTION	REMEDY
Fraudulent	A false fact made knowingly, or without belief in its truth, or recklessly, or carelessly as to whether it is true or false, with the intention to induce a person to enter into a contract, and which was relied on and did induce the contract, causing the innocent party to suffer loss.	Remedy in the tort of deceit for damages. Rescission in equity and/or damages at the option of the injured party in contract. May be a remedy under the Fairness of Transactions Act.
Innocent	The maker of a statement of fact believes it to be true at the time of making—there is a lack of intentional deceit.	No remedy in tort. Right in equity to rescind or resist an action for specific performance. May be a remedy under the Fairness of Transactions Act.
Negligent	The maker of the statement innocently but carelessly makes a false statement, which the innocent party relies on and consequently suffers loss.	Remedy in tort of negligence for damages; contract may be rescinded.

What is fraudulent misrepresentation?

Fraudulent misrepresentationis distinguished from innocent misrepresentation by the intentional deceit of one party by the other. Fraudulent misrepresentation refers to a deliberate false statement made with the intention of inducing someone to enter a contract. The contract, as it is induced by fraud, is voidable at your optionif you are the deceived party because it does not represent the parties' true agreement.

Where false information is provided with knowledge, or the persons preparing the information were reckless as to its truth or falsity, or if there is a reasonable expectation that if information exists it will be disclosed (a duty of disclosure), if you are the deceived party, you will have a remedy in damages and rescission.

Just as a matter of interest, while both fraudulent misrepresentation and the tort of deceit share similarities, the standard of proof differs with the tort of deceit requiring a higher standard of proof and the remedies may differ. Under the tort of deceit, the injured party

may seek compensatory damages, but include punitive damages to punish the defendant.

How do you prove fraudulent misrepresentation?

To amount to a fraudulent misrepresentation, the following elements **must all**be established:

- There must be a deliberate false statement of fact, not opinion, unless the person making the statement did not hold that opinion. The statement may be written, oral or by conduct. While, as a general rule, there is not a positive obligation on a person to disclose facts, exceptions to this rule include:
- contracts of utmost good faith (insurance contracts)
- statements which are only partially true or distort the truth
- statements which are true at the time of making but change before the contract is entered into
- where silence, having regard to all the circumstances, is likely to mislead or deceive
- the representation must be untrue
- the person making the representation must know that it is false, or not believe in its truth, or be recklessly careless
- the representation must be made with the intention that the other party acts in reliance on it
- the statement must actually induce entry into the contract. That is, you must act on it, although it does not have to be the sole reason for inducing the contract and it is no defence that you were able to check the accuracy of the representation and did not do so; **and**
- you, as the innocent party, must have suffered some loss, although you also have an obligation to mitigate your loss.

Just remember, the fraud must be distinctly pleaded, clearly proved and a misrepresentation of fact going to the root of the contract or your claim for loss will fail. Fraud must be shown. Carelessness on its own is not enough. An interesting question here is whether an injured party today would be better bringing an action under – for example, the*Fairness of Transactions Act 1993* rather than relying on the common law.

Business tip

Fraudulent misrepresentation (and the tort of deceit) is a tortious action, *not* contractual, and intention to mislead is a critical part of that action. On discovering the fraud, you, as the deceived party, *must* elect either to affirm (and lose the right to subsequently rescind) or to rescind (which must be done promptly and only if the parties can be returned to their original positions) and seek damages.

What is an innocent misrepresentation?

An innocent misrepresentation is a misstatement of a material fact, but made without intention to mislead – that is, in good faith or on reasonable grounds to believe that their statement was true – by one party and not known by them to be false, which induces you, as the other party, to enter into the contract. These are statements that are notterms of a contract and so there are no remedies for breach unless:

- there has been a total failure of consideration; **or**
- the misrepresentation is a term of the contract.

If you want to succeed in an action based on innocent misrepresentation you must be able to show all of the following:

- that the other party made a false representation or statement of one or more facts at the time the transaction took place
- the representation or statement was an important element of the transaction
- that the representation or statement was not true
- you would not have entered into the transaction if the seller had not made the representation or statement and the seller knew this. Of course, if you would have bought the item regardless of what the seller said about it, your action would fail
- you suffered a loss as a result of relying on the seller's representation and entering into the contract; **and**
- the seller benefited from the sale, as in, they sold you the goods.

Reflection questions

Take another quick break and think about these two questions.

1. The vendor of a farm that you are interested in buying told you that it had never been used to raise cattle but in his judgment the property would easily be capable of carrying 500 cattle. This proved to be untrue. Can you now avoid the contract? Explain how.
2. Eddie had a 2023 Toyota Prado Land Cruiser, which he wanted to sell. He advertised it for sale for K100,000. Eddie eventually sold it to Maria, who took it away, after giving him K90,000 cash. Unfortunately, the notes were forgeries and when he took the money to the bank the following morning, the bank refused to accept it and called the police. In the meantime, Maria sold the car through a firm of car dealers to Intergalactic Finance, who had no notice that Maria had acquired the car fraudulently. You bought the car in good faith and without notice of the defect in title. Do you have good title to it?

Negligent misrepresentation

Negligent misrepresentation lies in the tort of negligence, not contract. It arises when a person, not just a professional adviser, provides oral or written advice to another person in 'serious circumstances', knowing that the information or advice may be acted on, fails to take reasonable care to ensure the accuracy of the information. 'Serious circumstances' are where it would be reasonable to expect that a recipient might act on such advice and could suffer financial loss if the advice was given carelessly.

A negligent misrepresentation can include negligent pre-contractual statements between one contracting party and another, which do not form part of the contract, as well as the giving of information and advice. It is thus possible for a statement to be both a collateral contract or warranty (in relation to representations made in a pre-contractual context) and a negligent misstatement.

To succeed in an action for negligent misrepresentation, the plaintiff has to establish that a 'special relationship' existed between the parties and that they relied on the representation.

In brief

Establishing negligent misrepresentation

To establish negligent misrepresentation, the following guidelines are useful:

- A special relationship must exist between the parties such that the person providing the advice or information must be aware that the party seeking the advice or information trusts them to exercise a duty of care in the giving of that information.
- The subject matter of the representation must be of a serious or business nature.
- The person providing the advice or information must realise that the recipient intends to act on that advice or information.
- In the circumstances, it must have been reasonable for the recipient to rely on that advice or information.
- The person receiving the advice must suffer damage, usually in the form of monetary loss.

What remedies are available for misrepresentation?

In order to determine what remedies may be available to you as the innocent party, it is necessary to first determine the type of misrepresentation: is it:

- fraudulent misrepresentation—if the misrepresentation is serious and goes to the root of the contract you can rescind the contract and may have a right to damages
- innocent misrepresentation—the innocent party under PNG law may have no recourse at it is treated as case of let the buyer beware; **or**
- negligent misrepresentation—damages only (but in the tort of negligence)?

The right to rescind returns the parties to their positions before entering into the contract, but it can be lost irrespective of whether the misrepresentation is fraudulent or innocent in at least the following situations:

- if the innocent party waits too long to commence an action
- if the innocent party does something to affirm the contract after learning of the misrepresentation
- if the parties cannot be restored to their positions before the contract
- if there is an innocent third party who purchased the goods for value and in good faith then the third party will gain good title
- if there is unconscionable conduct by the plaintiff; **or**
- rescission would be inequitable.

Statutory modifications to the law relating to misrepresentation

The inability of the common law to satisfactorily deal with, in particular, innocent misrepresentations by not awarding damages has resulted in limited statutory intervention. *The Fairness of Transactions Act 1993* is relevant to certain transactions which are unfair or where there is a misrepresentation. Such contracts can be reviewed by the courts.

What actions can constitute duress or undue influence?

Duress

In brief

Types of duress

TYPE	DESCRIPTION	REMEDY
To the person	Actual or threatened violence to one contracting party, or their immediate family or near relatives.	Contract voidable at option of coerced party.
To goods	Wrongful threats to seize, damage or destroy the goods of one contracting party.	Contract voidable at option of coerced party.
Economic duress	Economic pressure beyond normal acceptable commercial practice, e.g., where the other party to a contract threatens to cancel, which will cause you to go bankrupt, unless you agree to their new demands.	Contract voidable at option of coerced party.

Duress is the use of violence or illegal threats against a person, their goods or their economic interests to force them to enter into a contract against their will. The duress does not have to be the sole reasonfor the coerced party entering into the contract, it just has to be one of the reasons. The onus is on the party who has made the threat to show that it had no effect on the other party, and if they cannot do that, the contract is voidable at the option of the coerced party because there is a lack of voluntary agreement.

- **To the person**

Duress to the person, such as yourself, can take the form actual or threatened violence to one contracting party, or to their immediate family, by or on behalf of the other contracting party. What is important is that the duress was a contributing factor. For example, getting a party to enter into a contract on the threat of criminal proceedings against you or your family.

To establish duress against you for example, it has to be established that:

  - that the duress by the other forced you to do something against your will, or that was not in your best interests, because of the use of coercion or threats that seemed credible
  - the duress prevented you and the other party from meeting and negotiating on equal terms; and
  - as a result of the duress, you felt you had no other option but to enter into a contract that you would not normally have entered into.

- **To goods**

Duress to goods or property could occur where one party carries out or threatens to carry out the detention, seizure or damage to goods or property of you in order to induce you to enter into a contract with them. You, as the coerced party, would have to show that the other party (the coercing party) used extreme pressure on you, thus leaving you with no real alternative but to enter into the contract – for example, burn your business down and put you out of business if you did not agree to enter into a contract.

- **Economic duress**

This type of action is restricted to commercial activities and the illegitimate use of economic pressure to force a business into entering into a contract that it might not otherwise have entered into. The difficulty here is distinguishing between legitimate commercial pressure, where the parties are of equal bargaining power, and economic duress. It is not a tort per se, and so gives rise only to an action for and avoidance of the contract, not to an action for damages.

To succeed in this action, you would have to establish two elements:

- the pressure was *one* of the reasons the coerced party entered into the contract; **and**
- the pressure was such (for example, unlawful threats or unconscionable conduct) that it was beyond what could be accepted as reasonable commercial practice. But it

should also be noted that overwhelming pressure, not amounting to unlawful threats or unconscionable conduct, will not necessarily constitute economic duress.

It is sufficient if you can establish that the illegitimate pressure was one of the reasons for entering into the contract. The onus then shifts on to the other party applying the pressure to show that they did not contribute to you entering into the contract.

Undue influence

Undue influence, which is based in equity, involves the improper use of a position of influence or power possessed by one person over another in order to induce the latter to act for the former's benefit. The contract is *voidable*at the option of the innocent party, and the usual remedy is rescission.

In brief

Types of undue influence

TYPE	DESCRIPTION	REMEDY
No special relationship	Improper use of a position of influence or power—onus on the plaintiff (P) to prove the defendant (D) exercised influence.	Contract voidable at option of weaker party.
Special relationship	Unequal relationship presumed to exist between D and P because of parental or confidential relationship—onus on D to prove that the transaction was voluntary and that P understood the contract.	Contract voidable at option of weaker party.

Can a special relationship be presumed to exist?

Undue influence is presumed to exist in situations where there is a special relationship of trust and confidence between the parties. Examples of special relationships include:

- parent and child
- solicitor and client

- religious adviser and devotee
- doctor and patient
- guardian and ward.

The onus is on the weaker party to prove a special relationship exists. It is then up to the dominant party – that is, the parent, the solicitor, the religious adviser, the doctor or the guardian – to show that that the transaction was a voluntary one and that there was no undue influence exercised over the weaker party.

What if no special relationship exists?

The onus is on the weaker party to prove that the other party (the dominant party and the defendant) exerted influence over them, and thus obtained a contract that they would not otherwise have made.

Examples in this class would include taking advantage of a person who makes a gift of the whole or the bulk of their estate if they:

- suffer from religious delusions
- believe in messages from the dead through a medium
- have little or no education.

The effect of undue influence on the contract, like duress, makes the contract voidable, leaving the innocent party with a right to rescind if they wish. However, the right to rescission can be lost if:

- an innocent third party gets involved; **or**
- rescission does not occur *within a reasonable time* (what is a reasonable time is question of fact and depends on the circumstances – for example, whether the contract is for goods that are perishable.

Reflection questions

Time for another break. Think about these questions and how you would answer them if you were the plaintiff.

1. What would you need to establish if you were the plaintiff in order to succeed in an action involving a negligent misrepresentation? Explain why.
2. Explain the meaning of the term 'duress' and distinguish it from 'undue influence'.
3. Cases of undue influence fall into one of two classes. Briefly explain what the two classes are and give examples.
4. Allcare joined a religious order in 2019 aged 19 as a novice nun. In taking her vows of chastity, obedience and poverty she had to give away all her goods and money which she donated to the sisterhood. She left the sisterhood in 2024. Is Allcare entitled to get her goods and money back? Explain why.

What are unconscionable (unfair) contracts?

What is the position at common law?

While contract law assumes that the parties are in equal bargaining positions, the reality is that this is often not the case. Many contracts today are what we call 'standard form contracts.' These are non-negotiated pre-written agreements and popular with sellers of high–volume goods and services. Some examples you may have encountered include lease/rental agreements, mobile phone agreements, bus and airline tickets, purchase of white goods, televisions and computers from retail stores to mention but a few.

The problem with standard form contracts is that one party, usually the seller, has a superior bargaining position and is able to force you as the buyer, because of a 'special disadvantage', into a contract which may be unfair, harsh or oppressive contract (and which can be described as unconscionable).

The general rule at common law is that the courts will not interfere with such a contract. However, in its equitable jurisdiction the court may set aside a contract as unconscionable where there has been an abuse by the defendant of their superior bargaining position in their dealings with the plaintiff.

Unconscionable conduct leading to an unconscionable contract involves questions of fact and degree, and each case must be judged on its facts. If the facts show that the conduct of the defendant was such that in its factual setting fairness and good faith could properly be expected to be exercised, and it can be shown that they were not, then the conduct of the defendant may be described as unconscionable.

However, it should not be assumed that every unfair contract is automatically also unconscionable and should be struck down. You, for example, will make bad business decisions which can prove to be disadvantageous to you, but it does not necessarily mean that the courts will then automatically find in favour of the other party. Among other things, the courts will look closely at whether the disadvantaged party has done anything to help themselves – for example, by seeking, or being told by the dominant party to seek, independent advice.

In brief

What has to be established for a contract to be set aside as unconscionable?

Not every unfair contract is going to be set aside on the grounds of unconscionability. For a contract to be set aside on the grounds that it was unconscionable, you as the plaintiff must prove that:

- you were in a position of 'special disadvantage' at the time of the contract
- it must have substantially affected their ability to protect themselves
- the defendant must have known, or should have known, of the plaintiff's 'special disability;' and
- the defendant had taken unfair advantage of it in such a way that the actions of the defendant were unconscionable (that is, unfair or unjust).

What is a special disadvantage?

What amounts to a 'special disadvantage' is difficult to accurately define, but includes poverty, need, sickness, age, sex, drunkenness, illiteracy or lack of education, or lack of assistance or explanation where assistance or explanation is necessary. Disparity in bargaining power would not be enough to constitute special disability.

Statutory modifications to the common law

Unfair contract terms

In addition to the common law position, s 4 of the *Fairness of Transactions Act 1993* also

addresses the use of unfair contract terms in contracts. Remember that the overall purpose of this Act is to 'ensure overall fairness of any transaction…' where one party for reasons of economic or other advantage is in a superior bargaining position and the other is not able to exercise a free choice…' or the transaction '…appears to be manifestly unfair or not genuinely mutual' (Part 1, s 1(a)). If a court finds that the overall fairness of the transaction is unfair under s 1(a), the court can re-open, review and rectify the transaction (s 1(b)).

The focus of the *Fairness of Transactions Act 1993* is on fairness (s 4) and in the case of a matter going to court, at first instance the court shall attempt a mediated settlement (s 7) and should that fail, the court will then proceed to review the matter (s 8).

Business tip

Steps to avoid claims of unconscionable conduct

For businesses to reduce problems of unconscionability arising in equity or statute law, you should ensure that:

- there is equality of bargaining power
- there is an opportunity to negotiate
- if one of the parties is at a 'special disadvantage' – for example, because of health, age, mental capacity, education, literacy or economic circumstances – they have time to consider the contract
- independent legal advice is available if one of the parties is at a 'special disadvantage'
- the language of the agreement is in 'plain English' (easy to understand)
- pamphlets are produced in several languages explaining the contract; **and**
- normal commercial practice has been followed.

Reflection questions

Time for your last break. Again, reflect on what you have just read and think how you would decide the following questions based on real cases.

Question 1

FACTS: The Buttresses had known the Johnsons for some 20 years. When Mrs Buttress was dying, Mrs Johnson had helped look after her and her husband. After Mrs Buttress had died, Mr Buttress, who by this stage was elderly, illiterate and demonstrating 'strangeness in disposition and manner', began to live a somewhat eccentric lifestyle, living in a shack which he built next to the cottage he had lived in with his wife. Mr Buttress said that he wanted Mrs Johnson to have the cottage after he died as thanks for looking after him and his wife. Mrs Johnson's solicitor prepared the necessary documents after ensuring that was really what Mr Buttress wanted. After Mr Buttress died, his son sought to have the gift set aside on the grounds of undue influence.

ISSUE: Had Mrs Johnson exercised improper or undue influence over Mr Buttress? Who has the burden of proof?

DECISION: What do you think? Why?

NOTE: This was a very finely balanced case.

Question 2

FACTS: An elderly Italian couple, with little understanding of written English or formal education, signed a guarantee and mortgage over a block of shops to the Commercial Bank as security for payment of the debts of one of their son's companies. Their son was a property developer and builder. At the time of signing, they were led to believe by their son that the guarantee and mortgage were for up to K150,000 and limited to six months. They were also told by their son that the company was in a good financial situation, when in fact it was in serious financial trouble.

When the bank manager brought the papers to the Amadios' home for them to sign the mortgage and guarantee, he corrected their misunderstanding about the length of time the guarantee was to run for, explaining that it was for an unlimited time and not six months. However, he did not explain the possible effects of the documents, which the Amadios could not read, and he made no mention of the fact that the amount was unlimited. When the son's company went into liquidation and the bank attempted to exercise its rights under the mortgage/guarantee, the Amadios attempted to have the contract set aside.

ISSUE: Was the conduct of the bank such that it could be regarded as unconscionable?

Had the bank taken unfair advantage of its superior bargaining position for its own commercial gain?

DECISION: So, what do you think here?

HINT: The test for unconscionable conduct is by reference to the special disability that may disadvantage a weaker party in a transaction, with the focus on the exploitation by one party of another's disadvantage.

REFLECTION: Do you think that the conduct of the bank would still be unconscionable if the Amadios' had had the benefit of independent legal advice?

Question 3

FACTS: Diprose fell in love and became infatuated with Ms Louth, who did not have similar feelings towards him. When Ms Louth falsely told Diprose that she and her two children were going to be evicted from the house they occupied, Diprose gave her money to buy a house in her own name.

ISSUE: Was Diprose under a 'special disadvantage', in the sense that Ms Louth had exploited his feelings for her and manipulated him to her financial advantage, or was this a case of an imprudent gift?

DECISION: And the final question. What do you think here?

REFLECTION: Do you think that if the roles had been reversed, and Ms Louth was infatuated with Diprose, you would have arrived at the same decision?

Key points

An understanding of the following points will help you to better revise and understand the material in this chapter.

- **What is the effect of mistake on a contract?** The courts are reluctant to strike down a contract just because of mistake. However, if mistake is established, the contract is void in the case of common and mutual mistake, but in the case of unilateral mistake, and depending on the circumstances, the contract may be declared void or voidable.
- **What are the different types of mistakes with contracts?**

    - **Common mistake** involves agreement, but there is a common error as to the existence or identity of the subject matter – for example, a contract to sell goods, which, unknown to the parties, were destroyed before the contract was made.
    - **Mutual mistake** involves a mistake made by both parties concerning a material fact that is important to the subject matter of the contract, so there is no genuine consent – for example, you have agreed to sell your car, thinking it is a 2022 Toyota Prado. The buyer has agreed to buy your Prado, but thinks it is a 2023 Prado.
    - **Unilateral mistake** involves only one party being mistaken about a material fact regarding the subject matter of the contract so there is no matching of offer and acceptance, thus there is no real agreement – for example, A contracts with B thinking B is C, and B knows of A's mistake.
- **What is the effect of a mistake on a written document, and what is the operation of the *non est factum* rule?** A successful plea of *non est factum* (it is not document or deed) will result in a court declaring the contract void for mistake. To succeed in such a plea, if you are the mistaken party must believe that the document you signed is radically different from what you believed it to be. That is, the mistake must go to the fundamental nature of the document and not its contents and there must be an absence of carelessness or negligence in the execution of the document.
- **What is the difference between fraudulent and innocent misrepresentation, and what is their effect on a contract?** Fraudulent misrepresentation is distinguished from innocent misrepresentation by the intentional deceit of one party by the other. Fraudulent misrepresentation is the basis of the tort of deceit, and the remedy for you if you are the injured party lies in tort. You, as the innocent party, can:
    - raise the fraud as a defence and counterclaim for damages if the other party attempts to enforce the contract
    - repudiate the contract and sue for restitution if the contract has not been completed; **or**
    - carry on with the contract and sue for damages in tort. An innocent misrepresentation is one made honestly, but mistakenly, in believing the facts to be true, both at the time of making the statement and at the time of contracting. Because it is neither fraudulent nor negligent, there is no remedy in tort but there may be a remedy under s 4 of the *Fairness of Transactions Act*.
- **What is required to amount to negligent misrepresentation?** In order to succeed in an action for negligent misrepresentation, the plaintiff is going to have to establish that a 'special relationship' exists between the parties in addition to the normal elements required to succeed in a negligence action – that is, duty, breach and damage.
- **What is the meaning of the terms 'duress' and 'undue influence'?**
    - **Duress** is the use of violence or illegal threats against a person, their goods or

economic interests to force them to enter into a contract against their will. Thus, there is a lack of voluntary agreement and the agreement is voidable at the option of the innocent party.

    - **Undue influence** involves the improper use of a position of influence or power that one person has over another in order to induce the latter to act for the former's benefit. It is an equitable doctrine that makes the contract voidable at the option of the innocent party.

- **What constitutes unconscionable conduct at common law?** A transaction can be described as unconscionable when there has been an abuse by the defendant of their superior bargaining position in their dealings with you, if you are the plaintiff. If the facts show that the conduct of the defendant was such that in its factual setting fairness and good faith could properly be expected to be exercised, and it can be shown they were not, then the conduct of the defendant may be described as unconscionable. Again, the *Fairness of Transactions Act 1993* might provide a remedy.
- **What is the effect of the *Fairness of Transactions Act1993* on unconscionable conduct?** Look at s 4 of the *Fairness of Transactions Act 1993* which sets out the concept of fairness based on principle of what is just and equitable and then look at the circumstances of the parties existing before, at and after entering into the transaction and consider whether there or not there has been a failure to observe the principles of fairness.

10.

LEGALITY OF OBJECT AND FORM

Learning objectives

By the end of this Chapter, you should be able to:

- Explain why some contracts are void or made illegal by statute and its effect on the contract.
- Explain the types of contracts that are illegal and types of contracts that are void.
- Describe a restraint of trade and explain situations where such restraints are reasonable and legally enforceable.
- Explain what 'form' is and its effect on a contract.

Key Terms

An understanding of the following terms will help you understand the material in this chapter on legality and form:

- **Form:** in the sense it is used in contract law, those statutory procedural requirements that need to be satisfied for some contracts to be enforceable
- **Restraint of trade:** an agreement in which a party agrees to restrict or restrain their activities in the future to carry on their trade, profession or business with other persons who are not a party to the contract
- **Void:** of no legal effect
- **Voidable:** an agreement that may be affirmed or rejected at the option of one of the parties

Introduction

1. In the last two chapters we looked at the questions of capacity to contract (Chapter 8) and genuine consent (Chapter 9). In this chapter we will look at the questions of legality and form and once we have answered these questions, we will know whether the contract we created in Chapters 5 to 7 is valid. If it isn't, then what is it? Is it voidable, void or unenforceable contract?
2. In this chapter we are concerned with two questions:

    - Was the purpose of the contract legal (the question of **legality**)? If it is not, we have a problem.
    - Are there any statutory requirements that need to be met (**form**)?

In this chapter consider the legal position of the parties where the contract we created is illegal or void by statute or common law. Because of the importance of restraint of trade to business, it is very useful for you to have a knowledge of it in business. Of particular importance are the restraint of trade clauses in contracts of employment and the restraints imposed on the seller (vendor) of a business.

This chapter then completes the question about the validity of the contract that you created. However, this is not the end of the story. You still need to know what has been agreed to, that is, what are the terms of the contract (Chapter 11) and what happens if you, or the party you contracted with, don't carry out what has been agreed to in the contract, as in, has there been a breach (Chapter 12).

Step 6: Is the purpose of the contract legal?

If you are satisfied that there is no issue with the questions of either capacity or consent, then the last of the factors you must consider is illegality and form. Are the objects, or purpose, of the contract that we created legal, and are there any statutory requirements that we need to satisfy?

Because some contracts, and certain clauses in some contracts, may be **void**or **illegal**at statute or common law, it is important to understand the distinction between void and illegal contracts. Without that understanding, it is not possible to see the different consequences that can flow from each at statute or common law.

What type of contracts are illegal by statute?

What is the extent ofinvalidity?

The extent to which Parliament may wish to ensure that neither party has any rights or remedies at all under the transaction, or to go further and impose penalties for such an agreement, will depend on the construction of the statute's terms in each case. This requires the court to consider two questions:

- Did the statute mean to prohibit such contracts at all?

If the answer is '**yes**', then:

- Does the contract in issue belong to the class that the statute intends to prohibit?

Ultimately, the answer to the second question hinges as much on public policy as anything else, with the court considering what mischief the statute is intended to prevent, as well as the language used and the consequences for the innocent party.

What is the legal position of the parties where the contract is illegal by statute?

There are a number of ways in which a contract may be affected by a statutory provision:

- The contract may be to do something that a **statute expressly prohibits**such as a type of contract or term such as prohibiting unlicensed dealing in goods
- The contract may be one where the statute **expressly or impliedly**prohibits the making of the agreement itself and the contract is illegal as formed
- A statute may require that the contract must be performed in a certain way – for example, when providing a purchaser with an invoice, stating the percentages of certain chemicals contained in fertiliser. While the contract might be lawful in its formation, failure to **perform**the contract in the prescribed manner could result in the contract being **illegal**and unenforceable **as performed**, and therefore unenforceable.

The courts are reluctant to find that a contract is illegal by statute unless a 'clear implication' to that effect can be drawn from an examination of the statute. In trying to decide this, the courts consider whether the statute means to prohibit the contract or regulate the way the contract can be performed. What is the sole object of the statute? If **the illegal behaviour is only incidental**to the way the contract was completed, the court will **not**be prepared to find that the contract was unenforceable.

To some extent, the approach of the courts in considering whether a contract will be void or unenforceable based on illegality where a statute is involved is one of statutory interpretation. What was the intention of Parliament? Did it intend a fine to be sufficient punishment or did it intend the contract to be void or unenforceable as well?

What is the legal position of the parties where the contract is void by statute?

While some contracts are illegal as formed or performed, whether they are unenforceable depends on the intention of the statute. Other contracts may be made void by statute.

A contract void by statute will not be enforced by the courts and there are no rights that can be enforced by either party – for example, gaming or wagering contracts, certain money lending practices under the consumer credit legislation and some contracts with minors/infants (see chapter 8). Sometimes, instead of striking down the whole contract, a statute may declare that only part of the agreement is void, and the remainder valid.

Subsequent transactions directly related to the contract rendered void by statute, but not illegal, may themselves be rendered void if that is the intention of the statute. If the subsequent transaction is to get its validity from the earlier contract, which is now rendered void by statute, then that transaction will fail because the consideration for the later contract is the validity of the earlier one. As this no longer exists, there is a total failure of consideration.

If the contract is rendered void, but **not**illegal, any money paid under the contract is irrecoverable, irrespective of whether or not the party who has paid it can prove a total failure of consideration. However, any amounts paid under a void contract **may**be recoverable in restitution.

Reflection questions

First break. Reflect on what you have just read and think about the following question.

1. Brass hired a roulette table, with all the ancillary equipment needed to play roulette, from ACME Hire. When they entered into the contract, neither party was aware of

the provisions of their state's gaming and betting legislation that made the game unlawful but did not prohibit it. When Brass discovered the Act, he refused to pay the hire price. Can ACME Hire recover the hire charges?

What is the common law position of contracts that are illegal and contracts that are void?

In brief

Contracts illegal at common law

The main classes of contract illegal at common law are:

- contracts to commit a crime, tort or fraud against a third party
- contracts that promote sexual immorality or prejudice the status of marriage
- contracts that are to the prejudice of public safety or good relations with foreign countries
- contracts that are prejudicial to, or delay, the administration of justice
- contracts that promote public corruption
- contracts that defraud the state of revenue; **and**
- contracts that involve a breach of duty.

What type of contracts are illegal at common law?

Are contracts to commit a crime, a tort or a fraud against a third-party void?

The courts will not enforce a contract that has as its object the breaking of the law. For example, a contract between robbers to divide the proceeds of a robbery or commit tax fraud would be void because the purpose of the contract is illegal.

Are contracts that are sexually immoral unenforceable?

Contracts violating the social or moral attitudes of the community are prohibited as being contrary to 'public policy'. Of course, an interesting question here is what exactly does 'sexually immoral' mean?

Are contracts that are to the prejudice of public safety or of good relations with friendly countries valid?

There are two types of agreement here:

- an agreement with an enemy alien
- an agreement that could endanger friendly relations existing between two countries.

In both cases, an agreement would be regarded as illegal and unenforceable.

Are contracts prejudicial to the administration of justice unenforceable?

Any attempt to affect the administration of justice is illegal and void.

Are contracts that tend to promote corruption in public life invalid?

Contracts which involve the corruption or bribery of a public official are illegal. A contract that interferes with the impartial judgment of public officials, including Members of Parliament are invalid because they involve corruption.

Are contracts to defraud public authorities of revenue invalid?

A clear infringement of public policy can be found in agreements that intend to defraud the revenue of a country, whether at the national, state or local level are invalid because they involve corruption.

Are contracts that involve a breach of duty by an employee invalid?

Contracts involving a breach of duty by an employee or agent are generally illegal. If the breach of duty by the employee endangers others, then the contract is void. But what if the contract, while it involves a breach of the employee's duty, has as its purpose to improve the safety and protection of other employees?

What type of contracts are void at common law but not illegal?

In brief

Contracts void at common law

These three types of contracts (or clauses in contracts) are void, but not illegal, at common law:

- contracts prejudicial to the status of marriage, but see the *Marriage Act 1963*
- clauses in contracts that attempt to oust the jurisdiction of the courts; **and**
- clauses in contracts in restraint of trade.

Can you oust the jurisdiction of the courts?

If the parties try to create a legally binding contract but include a clause attempting to oust the jurisdiction of the courts, in the event of a dispute the clause will be void and, if possible, severed. If the clause cannot be severed, the contract will be void.

A contract with a clause providing for arbitration in the event of a dispute between the parties will be valid only if it is to operate as a condition precedent to any recourse to the courts. It cannot attempt to exclude review of the arbitrator's decision by a court if there is, for example, a denial of natural justice or the application of the wrong law. Note that an arbitration clause is common in commercial transactions because it provides the parties with a quicker, cheaper and simpler resolution of a dispute than they will get through the courts.

Problems can arise where courts are asked to distinguish between contracts that attempt to oust the jurisdiction of the courts and contracts that are binding in honour only. In the latter, the parties expressly declare that they do not intend to create legal relations.

Are contracts in restraint of trade void?

While a person should be bound by their contracts, one of the fundamental rights in contract

law is a person's freedom to contract. Contracts, or clauses (called 'covenants') in contracts, that attempt to restrict or restrain the freedom of one party to contract are not illegal, rather, they are **unenforceable at common law because they are against public policy unless** it can be shown by the party relying on the clause is **protecting a legitimate business interest** (such as goodwill, trade secrets or confidential information) **and is reasonable.**

It should not be assumed that issues of restraint of trade are restricted to just the common law. Contracts (or clauses) that are in restraint of trade can also be caught by legislation such as the *Independent Consumer and Competition Commission Act 2002.*

What is a restraint of trade?

What is the position at common law?

The common law view of clauses in restraint of tradeis that they tend to:

- injure the person involved by reducing their means of earning a livelihood (as in, by restricting their freedom to work)
- deprive the public of the services of persons in the capacities in which they may be most useful to the community as well as to themselves
- discourage industry and enterprise and reduce the products of ingenuity and skill, **and**
- restrict competition.

Even today, many contracts, and clauses (covenants) in contracts, attempt to restrict the freedom of one party to the contract to do something in the future. For example, in contracts of employment there is often a clause providing that, on termination of employment, if you are an employee that you will not compete against your employer for a certain period. If you are working, have you ever looked at your contract of employment to see what the terms and condition of your employment are?

In the sale of a business, to protect the purchaser's goodwill, there will usually be a clause prohibiting the vendor (the seller) from setting up a similar business within a reasonable distance and for a reasonable time near you if you are the purchaser. In contracts between manufacturers and traders, it used to be common to find clauses restricting the trader from selling the manufacturer's goods below a certain price or to a competitor

A contract, or clause in a contract, is a restraint of trade if it limits freedom to trade. At first sight it appears to be void because it is considered to be contrary to public policy. However, this is a presumption and **if the person relying on the contract or a clause in a contract can show that the restraint is reasonable**, the restraint may be enforceable.

What has to be shown for a restraint clause in a contract of employment to be valid?

Because employees often have access to confidential information, business contacts, trade secrets and the like, it is not unusual for employers to try to incorporate a restraint of trade clause or covenant into the employee's contract of employment. The reason for such a clause is to attempt to stop employees who change employers from giving their new employer confidential information about their previous employer.

Restraint of trade clauses in contracts of employment usually take two forms:

- **restraints on the use of confidential information or trade secrets learnt during employment** – for example, secret formulas (such as the recipe for Coca-Cola) and processes; or
- **protection of trade connections**, such as customer lists, but only to the extent where the employee has come into contact with the clients or customers and has acquired influence over them – a restraint against an employee who has had no contact with the employer's clients or customers would not succeed.

The following factors should be considered when trying to decide whether information was 'secret' and therefore protectable, or 'general know-how' and generally not protectable:

- the extent to which the information is known inside and outside the business
- the value of the information to competitors
- the effort spent in developing the information; **and**
- the difficulty in acquiring or duplicating such information.

In the case of **trade secrets**, an employer may generally validly restrain an employee from making any unauthorised use of that information both while working for them and for a **reasonable time after the contract of employment has ended.** An employer is entitled to protect and safeguard the confidential techniques they have developed. They could therefore legally restrain a former employee from using the information while employed by a rival firm. However, note that while an employer is entitled to protect their trade secrets, they cannot prevent an employee from using their own skills and knowledge after they have left the employment, even if those skills were learnt from the employer.

Even then, it is still very difficult to convince the courts that the restriction placed on the employee by the employer is reasonable and not in restraint of trade. The reason for the court's attitude is that frequently there is an **inequality in the bargaining power between the employer and the employee,** with the employer dictating the terms on which the employee may accept the position. As a result, the courts will look at the relative bargaining power of the parties. One of the factors which would support the reasonableness of a

restraint is if both sides took legal advice so there was no inequality in bargaining power between the parties.

As a general rule, if there is an inequality of bargaining power between the parties, the courts will interpret these clauses contra proferentem –that is, strictly against the party relying on them (in this case, the employer). As a result, if the clause is merely an attempt to limit competition, the courts will usually find little difficulty in striking down the clause.

In brief

A person calling something 'confidential' does not automatically make it confidential within the scope of what equity will protect. It must be something that is not public knowledge or public property.The matter of confidentiality is viewed at two points in time:

- For the purposes of determining whether the information is confidential and should be protected, look to the facts at the time the parties made their contract
- Whether an injunction should be granted is determined by looking at the facts at the time of the hearing.

When is a restraint clause valid in a contract of employment?

A restraint clause in a contract of employment that will be held to be valid in most instances is one that goes to the employee's present employment and provides that the employee must not compete directly or indirectly (either with a rival firm or even operating as a sole trader) while still working for their current employer.

The **primary duty of an employee is to the employer.** This situation must be distinguished from situations that relate to the position of employees after leaving their present employment. The question that then should be considered is whether a former employee should continue to owe a contractual duty to their former employer.

The case where the employee is going to be held to their contract is one **which isreasonable or fair, considering the interests of both parties**.In *A Schroeder Music Publishing Co Ltd v Macaulay* [1974] 1 WLR 1308 (an English case), the publishing company had used its superior bargaining power over Macaulay (a young, unknown song-

writer) and a 'take it or leave it' contract to exploit Macaulay's earning power for the next 10 years. As a result, the bargain between the parties was unconscionable, or not fair, since the terms combined required a total commitment by Macaulay with a total lack of obligation by the publishers.

Business tip

Making an employer–employee restraint valid

Because the parties in an employer–employee relationship are (usually) in an unequal bargaining position, restraint clauses in employee contracts will be struck down by the courts unless they:

- only protect intellectual property rights (such as trade secrets) or customer connections, or prevent an employee from working for a competitor during their current employment
- are of reasonable length in time (this is a question of fact in each case and will be determined by what is being protected); **and**
- are of reasonable geographical width (again, this is a question of fact in each case and will be determined by what is being protected).

Care must be used, or the provisions of the *Employment Act 1978* may be triggered.

Reflection questions

Time for a break. But first, reflect on what you have just read regarding restraint clauses in contracts of employment, and apply that to these questions.

1. Explain why a restraint clause in a contract of employment is most likely to be struck down by the courts. In what circumstances will a restraint clause be likely to be considered valid in a contract of employment?

2. Samson was employed as a computer salesman. Part of Samson's contract of employment contained the following clause:
    - *The employee expressly agrees not at any time during one year after the termination of his employment . . . either on his own account or as a representative or agent of any person or company, to act as a computer salesman. . . for any person or company who at any time during the last two years of his employment shall have been a customer of the employer in the course of his employment.*
    - Is the restraint between Samson and his employer valid?
3. Roberta was employed as a works manager with Littlewoods Recycling Works in Port Morseby. Her contract of employment contained a restraint of trade clause whereby she agreed that in the event of leaving Littlewoods she would not work in the recycling industry in PNG for five years from the time of leaving the company's employ. Roberta has been approached by a rival firm in Lae who has offered to double her existing salary if she will go and work for them. Roberta wishes to know whether the restraint clause in her contract of employment is valid. What advice would you give her?

Can you impose a restraint on the vendor of a business?

In the sale of a business, where there is an element of goodwill, it is reasonable to expect that if you were the purchaser you would want to stop the seller from opening a similar business to the one, they just sold to you within a certain area and time period. Here it is assumed that the parties are dealing on a **'more' equal basis, and there is a legitimate commercial interest that requires protection** (as in, goodwill), and as a result the courts are generally prepared to uphold the validity of such clauses.

Each case should be treated on its own merits and it will be a **question of fact as to whether the restraint is reasonable**in its protection of your interest as the purchaser but not unreasonable in preventing the vendor from carrying on normal business activities. Look closely at whether the length of time and the geographic extent of the exclusivity clause and think about whether they were reasonable.

In brief

Factors that determine whether a restraint on a business is reasonable

Whether or not a restraint is reasonable in the interests of the parties and the public is determined at the date of the agreement after consideration of the following factors:

- the geographical extent of the restraint
- the time period involved
- the bargaining strengths and positions of the parties during the negotiations; **and**
- the type of business and the activity being restrained.

Where the sale of a business is concerned, note carefully the type of business, as the size of the area and the length of time will vary with the type of business. For example, if you buy a Toyota dealership you would expect that you would not want the seller setting up in competition just down the road. Also, look carefully at the wording of the restraint of trade clause in a contract. Ensure that it is clear and not vague. The question in each case is what is reasonable to protect the parties. Not only must the restraint be reasonable in area and time, but the size of the area and the length of time can vary with the type of business.

Keep in mind **that the size of the area and the length of time will vary with the type of business.** Thus, a restraint imposed on the vendor of a café will not be the same as the restraint imposed on the vendor of a car dealership, although in both cases it will still be valid if it is reasonable.

A restriction should not demand too much. Where a restrictive clause is held to be too wide, the likely outcome is that the clause will be void. The courts are very reluctant to narrow it to a reasonable scope.

While the courts will neither redraft nor narrow the operation of a restriction that is unreasonable, they will sever an unreasonable restriction from one that is reasonable if there are two restrictions. However, they must be **two separate restrictions and the severed restriction must not affect the meaning of the reasonable restriction.**

What happens in trading agreements?

It is not unusual to find a manufacturer or trader who will want to exclude competition from a market segment in which they operate in order to maximise their profits. This may take the form of, for example, exclusive selling or exclusive purchasing agreements. At common law, the validity of such agreements will depend on:

- whether the agreement is a reasonable restraint between the parties themselves; **and**
- whether it is in the interests of the public.

However, finding that such an agreement is reasonable at common law does not automatically mean that the agreement will have the force of law, because such agreements are also subject to statutory provisions such as the *Independent Consumer and Competition Act 2002,* so it might still fail on grounds of public policy.

Severance of illegal or void restraints of trade

If a clause is illegal or void by statute or common law, as may be the case with a restraint of trade clause, it doesn't necessarily follow that the courts will strike down the whole contract. As a general rule, the courts will not sever a clause from a contract which is illegally formed. However, severance can be used in relation to restraint of trade clauses where the clauses are void but not illegal as long as the court is able to delete the unreasonable parts and enforce the reasonable parts without changing the fundamental nature, scope or effect of the contract.

A common boilerplate clause is what is called a severance clausewhich documents the intention of the parties that, should a contractual term such as a restraint of trade clause be found to be void or illegal, it may be severed while the remaining terms of the contract will remain valid. However, if the removal of the illegal or void clause makes the contract unworkable, then the contract will still be void.

Reflection questions

You are at the end but before you go on to the next chapter just make sure you understand what you have read about restraint of trade and make notes as you go.

1. Do the courts apply the same criteria in assessing whether a restraint clause in a contract of employment is valid as they do in a contract involving the sale of a business? Explain why?
2. We asked you above that if you were to buy a Toyota dealership you would expect that you would not want the seller establishing competition just down the road but, if you bought a milk bar or cafè, for example, the geographic restraint might be just a couple of kilometres if it is in town (or more in the country). What we did not ask you is whether you would you use the same restraint clause in both purchases? Explain why or why not.

Step 7: Is the purpose of the contract legal?

The last step is establishing the validity of your contract. What you are doing here is checking that there are no statutory requirements that need to be met.

Certain contracts, to be valid and enforceable, are required by statute to be wholly in writing or they are void, such as bills of exchange, cheques and promissory notes (*Bills of Exchange Act*1951, ss 8(1), 79, 93(1)), while other contracts must be evidenced in writing. The absence of writing **does not**affect the validity of the contract, but it makes it unenforceable in a court, for example, *Goods Act 1951*, ss 4, 5.

The great majority of simple contracts that you will encounter in business or commerce will not be subject to any statutory requirements for them to be enforceable. You may choose to put a contract in writing if it is important for you or the other party to ensure some certainty about what it is you have agreed to do. Think about why it might be important to have a contract in writing, or at least evidenced in writing.

Key points

An understanding of the following points will help you to better revise material in this chapter.

- **What is the difference between contracts that are illegal and those that are void by statute?**Contracts that are illegal by statute will be either:
  - **illegal as formed**and unenforceable because they should never have been entered into; **or**
  - illegal as performed – the contract is legal as formed but performed in an illegal way or for an illegal purpose, and is not necessarily unenforceable if innocent conduct is incidental to performance
  - Contracts that are void by statute will not be enforced by the courts and create no enforceable rights between the parties – for example, gaming and wagering contracts.
- **In what ways may a contract be illegal under statute law?**Contracts that are illegal by statute may be illegal as formed because they are expressly forbidden by statute (for example, many licensing statutes) or illegal as performed, as the contract is performed in an illegal way or for an illegal purpose (for example, a taxi driver carrying more than the licensed number of passengers).
- **What is the difference between contracts that are illegal and those that are void at common law?**Contracts that are considered to violate social or moral attitudes of the community (for example, committing a crime or tort, or promotion of corruption) are illegal and may be subject to criminal penalties. Contracts (or clauses) that are void at common law – such as those that prejudice the status of marriage, oust the jurisdiction of the courts or are in restraint of trade (unless reasonable) – are unenforceable as a matter of public policy.
- **What is the effect of a clause in a contract in restraint of trade, and in what circumstances will it be legally enforceable?**A clause in a contract in restraint of trade will be unenforceable if it is not reasonable. Whether or not a restraint is reasonable in the interests of the parties and the public is determined at the date of the agreement after consideration of the geographical extent of the restraint, the time period involved, and the type of business and the activity being restrained. In the case of restraint clauses in contracts of employment, the restraint must be reasonable and there must be a protectable interest, such as confidential information or trade secrets. In the case of a vendor of a business, it is assumed that the parties are in an equal bargaining position, and the question then is: What is reasonable to protect the parties?
- **Why is the question of 'Form' important?** If the contract does not any meet statutory requirements it may make the contract void or unenforceable.

11.

CONSTRUCTION OF THE CONTRACT: TERMS AND CONDITIONS

Learning objectives

By the end of this Chapter, you should be able to:

- Identify terms in a contract and distinguish them from a representation.
- Discuss the parol evidence rule and the number of qualifications subject to it.
- Identify a collateral contract and explain the significance of its contractual effect.
- Recognise the importance of different terms, and identify conditions, warranties and statutory consumer guarantees.
- Explain the types of terms implied into a contract.
- Describe exclusion clauses, the approaches to their interpretation and the statutory protection available to consumers.

Key Terms

You will notice these key terms, which are mentioned throughout the chapter, to help you to better understand and remember the material:

- **Condition:** a stipulation going to the root of the contract, allowing the injured party the right to rescind and/or claim damages
- **Condition precedent:** a term in an agreement that delays the vesting of the right until the happening of the event
- **Condition subsequent:** a term in a contract that destroys the right on the happening of the event
- **Exclusion clause:** a contractual term that attempts to limit or exclude the liability of the person inserting the term into a contract
- **Intermediate or innominate terms:** contractual terms, the remedy for the breach

of which depends on the seriousness of the breach rather than on the classification of the term as a condition or a warranty
- **Parol evidence rule:** A rule of evidence which states that additional oral evidence is not considered by the courts to contradict, vary, add to or subtract from its terms when a contract is complete on its face
- **Standard form contracts:** contracts that incorporate terms of a standard nature, often in fairly wide terms, applicable to all persons making a particular type of contract
- **Warranty:** a term of lesser importance to the main purpose of the contract which, if breached, only allows the injured party to claim for damages

Introduction

Congratulations on getting to this point. You now have an idea how a contract is created and how we find out if what we have created is valid or not. But what is it you have agreed to in your contract? This is what this chapter is about, that is, what are the terms of the contract or to put it another way, what is the extent of the rights and obligations that you and the other party have entered into? These ‘terms’ can be expressed (as a condition, warranty, innominate term, condition precedent or condition subsequent; and qualified by, for example, an exclusion clause, or unqualified) or implied (or express and implied), or meaningless.

Believe it or not, it can sometimes be unclear from what the parties have said, written or done, what it is that they have actually agreed to. For example, they may disagree about the meaning of words in their agreement that relates to what the exact goods or services to be supplied are, what their condition is, where the goods might be delivered to, who is responsible for any damage, when payment is to take place, the start date, the completion date and so on.

The answer to what the parties have agreed can be found only by deciding what the terms of the contract are, and then you need to determine what their relative meaning and importance is. This often has to be done in the context of whether the terms that have been agreed to have been qualified or limited by the inclusion of an exclusion or exemption clause.

Examples

Ever wondered what an Employment Agreement might look like? To date you have just looked at the creation of the contract and what to look for to ensure its validity. In this chapter, we are looking at the terms you and the other party have agreed to.

The Wonder Legal Australia website has an Australian Employment Agreement complete with all its terms and conditions for you to look at as an example of a finished contract (short of signing of course).

There is a also a link to a Sale of Goods Contract used in New South Wales, Australia. Take a look and see what terms and conditions it contains.

While both examples are Australian, PNG contracts contain similar terms and conditions.

What are representations?

Representations are **statements of fact**. They are made **before the contract**by one party (an offeror) to **induce**(lead) the other party (an offeree) to enter into a contract. Unlike a term, they **do not form part of the contract**and are not intended to be legally binding. However, if the statements are pre-contractually misleading or deceptive, an action may lie under statute law (for example, s 4 of the *Fairness of Transactions Act 1993*, s 105 of the *Independent Consumer and Competition Commission Act 2002)*, or under common law as a negligent misrepresentation.

One way to minimise the problem with a pre-contractual representation is for a party to include a **'no representation/no reliance' clause** (what is referred to as a form of 'boilerplate' clause, which is a standardised term in a contract) at the end of the contract. It provides that the parties have not made any pre-contractual representations and, even if they have, that neither party has relied on any representation made by the other that is not contained in the contract.

In brief

The possibilities for a statement

In summary, the possibilities are that a statement could be one of the following:

- **a term:** in which case the statement will create contractual obligations between the parties, breach of which will result in the injured party being able to sue
- **a collateral contract:** that is, a preliminary contract on which the main contract is entered into, breach of which will result in the injured party being able to sue
- **a representation:** that induces an offeree to enter into the contract but that is not part of the contract and so is not actionable in contract law; or
- **a sales puff:** that is not intended to have any legal effect, in which case no remedy is available.

A 'no representation / no reliance' clause can also form part of another type of boilerplate clause called an **entire agreement clause.** This type of clause provides that the contract constitutes the entire agreement and understanding between the parties. It supersedes any previous agreements and understandings that might have been made between them.

The promissory nature of a statement, and whether it is a representation or a term, depends on the intention of the parties. The courts apply an objective test of a reasonable bystander, taking into account the conduct of the parties, and their words and behaviour, to try to distinguish between the two.

Why do the courts use objective tests?

In trying to ascertain the intentions of the parties from the particular facts before it and whether a statement is a representation or term, the court takes into account:

- **How much time has lapsed between the making of the statement and the final agreement?** The longer the lapse of time between the making of the statement and the final agreement, the more likely it is to be treated as an inducement and not intended to form part of the agreement.

- Where an oral statement precedes a written contract, then the terms of the contract tend to be contained in the written document, and all oral statements tend to be pre-contractual. However, it is important to **look carefully at the time the oral statement is made** in relation to the time the parties enter into a contract. If it is immediately before the contract is entered into, and subject to the importance of the statements and whether the person making it had special knowledge, a statement may form part of the contract.
- **Was the innocent party asked to check or verify the statement?** Here the statement is more likely to be an inducement – for example, a mechanic's report on a car.
- **Was the statement made with the intention of preventing the other party from finding any defects, and did it succeed?** If you as a buyer, on the basis of the statement by the seller just prior to your purchase that 'The car is in excellent condition, you don't need to look it over', and you then don't bother to look it over, then the statement would most likely be an inducement or a misrepresentation, but just note it is important to look also at the context in which the statement was made.
- A vital factor in determining intention is whether the representation had been made at or immediately before the time of sale and the way in which it was made. If it is clear that it was intended to convince the other party not to bother checking and it could be shown that it was intended by the parties to be relied on, then the courts are prepared to find that the representation formed part of the contract and that there was a warranty. **If the statement was made after the sale, then it was a representation and unenforceable**, as the contract had already been finalised.
- **What importance did the parties attach to the statement?** If the parties placed considerable importance on the statement, the courts would be more willing to treat it as a term and not as a mere representation. If a party did not rely on the statement, it would be a representation – for example, where approval of a third party was necessary before the written agreement would become binding.
- **Did one of the parties have special skills or knowledge?** Where one of the parties had some special skill or knowledge not possessed by the other party with regard to the subject matter of the contract, then a statement would more likely be treated as a term. In the English case of *Oscar Chess v Williams* [1957] 1 All ER 325, Oscar Chess, a car dealer, in 1955 bought what he thought was a 1948 model car (confirmed by the registration papers) when in fact it was a 1939 model. Some 8 months after the sale the dealer discovered the registration papers had been altered and the car was worth substantially less than what he had paid for it. The court held that the statement as to the age of the car was a mere representation that did not give rise to any liability for breach of contract. The dealer had special expertise as a motor vehicle dealer and should have taken steps to verify the age of the vehicle.

The statement could also have been construed as an innocent misrepresentation but what would have been the point as damages are not awarded for an innocent misrepresentation? Oscar Chess could have had the contract set aside in equity if he had acted promptly but it was 8 months before he did anything!

In trying to ascertain whether or not a statement is a term, the relative knowledge of the parties should be considered. **Which of the 2 parties is in the best position to know or determine the truth about the statement?** In *Oscar Chess* above, the majority view was that Williams was in no better position than the dealer (Oscar Chess) to assess the age of the car. Williams honestly believed, on reasonable grounds, that the statement as to age was true.

Compare the decision in *Oscar Chess* with that in *Dick Bentley Productions Ltd v Harold Smith (Motors) Ltd [1965]* 1 WLR 623, where a dealer sold a luxury car to the appellant (Dick Bentley Productions) and stated that the car had done only 20,000 miles since a new motor had been fitted. In fact, the car had travelled just under 100,000 miles. Here, the court held that the statement was of a promissory nature, as the seller was in a much better position to know the mileage, and so the representations amounted to a warranty rather than a mere representation.

Where the person making the statement is in a better position than the other party to assess the accuracy of the statement, it is probably a term. This is determined by trying to **establish the intention of the parties, objectively assessed on the basis of what an intelligent bystander would infer from their words and conduct.**

What is the parol (oral) evidence rule?

In the case of an**oral contract**, exactly what the parties said must be found as a **matter of fact**, and to this end the courts will admit as evidence all facts known to the parties, including both **actions and words**of the parties. Problems arise when the evidence is conflicting. Each party may have a different view of what was agreed to, and the meaning of what was said. This can raise difficult and costly problems of proof for you if you are the plaintiff.

What is a written contract?

Where the contract is completely in writing, the courts assume that all the terms agreed to by the parties are contained in the contract. However, problems may still arise in the interpretation of particular terms that the court may need to resolve – for example, where there is ambiguity.

In the case of a **written contract**, the court generally **will not admit evidence of acts or words of the parties before the execution**of the document if it has the effect of adding to, varying or contradicting the written agreement. This is because the courts assume that the parties' intention is contained within the 'four corners' (the text) of the contract, known as the **parol evidence rule**. However, this rule is subject to a number of qualifications to try to avoid hardship or injustice.

Business tip

To reduce exposure to litigation expenses, ensure that all of the relevant terms are contained in the document, and that there are no ambiguities. Another option is to include a 'no representation/no reliance clause' or an 'entire agreement' clause into the contract.

What has to be established for the parol evidence rule?

This is a rule of evidence which states that additional oral evidence is not considered by the courts to contradict, vary, add to or subtract from its terms when a contract is complete on its face unless it results in hardship or injustice, in which case the oral evidence can be heard:

- to prove a trade custom or usage
- to show that the contract has not yet become effective
- where the court is of the opinion that the written document contains only part of the agreement
- to clarify any ambiguous language used in the contract
- where, due to a mistake of the parties, their agreement was not accurately expressed in the written contract
- to demonstrate that a description is false; **or**
- to determine how important the truth of the statement was.

Whether a warranty is intended depends on the conduct of the parties: on their words and behaviour, rather than their thoughts. Thus, while a seller's statement may not be expressly designated as a term of the contract between the parties – that is, either as a condition or warranty – **it can be intended by the parties to form a condition subject to which**

the contract was entered into – that is, it was a collateral warranty, and was of sufficient weight to overcome the parol evidence rule.

What are the remedies for breach of a pre-contractual representation?

Where pre-contractual representations are concerned, there are a number of remedies available to an injured party at both common law and statute, as long as there is not a 'no representation/no reliance' or 'entire agreement' clause in the contract of course, and these can include:

- recission for misrepresentation
- negligence
- unconscionability at common law; **and**
- the *Fairness of Transactions Act 1993.*

Reflection questions

Time for another break. Have a look at the following questions and test your understanding of what you have just read.

1. Does it make any difference whether a statement is a representation or a term?
2. Explain the purpose of the parol evidence rule and how it is applied by the courts.
3. In trying to ascertain the promissory nature of a statement, and whether it is a representation or a term, what matters will the courts take into account in trying to ascertain the intention of the parties? Discuss.

PROBLEM

FACTS: Before signing a contract for the purchase of a house, you asked the seller whether there were any termites in the house. The seller told you there were none, and you immediately proceeded to sign the contract to buy the house. Some months later, you discovered extensive termite activity throughout the house which, according to an expert, showed that the termites had been in the house for at least 12 months. There was no reference in the written contract of the oral question relating to termites.

ISSUE: Could you rely on the oral statement made by the seller immediately before entering into the contract that there were no termites, even though it was not a written term in the contract?

DECISION: What have you decided?

CASE REFLECTION: Could you have argued that the vendor had fraudulently misrepresented the true position of the house when stating that it did not have termites since any reasonable inspection would have revealed their presence and the extent of the damage caused by them? Do you think that the seller's statement was made with the knowledge that it was false or recklessly, without caring whether it was true or false?

What are collateral contracts?

A statement which is not a term of the contract can sometimes be regarded as a collateral or a preliminary contract if it can be shown that the main contract would nothave been entered into in the absence of an earlier statement (look back at the problem question you have just done). In such a case the courts maybe prepared to enforce the promises made by the parties beforethey entered into the main contract. **The consideration to support the defendant's promise in the collateral contract is the making of the main contract.**

In order to establish a collateral contract regarding a statement of fact it is necessary to show that:

- the person making the statement **intended** it to be relied on; and
- the maker of the statement guaranteed its truth; and
- there was reliance by the person alleging the existence of the collateral contract.

Once a collateral contract is established, it is valid and enforceable if you are the plaintiff and can establish ***each*** of the following:

- the statement relied on is promissory (and not descriptive or representational)
- it is not supported by past consideration (the promise is agreed before the statement is made; **and**
- it is consistent with the main contract.

In brief

The significance of the collateral contract

Where a pre-contractual statement is not a term of the main contract, it may still have contractual effect as a collateral contract, thus providing the injured party with a remedy. **Such a contract has an independent existence to the main contract and may be enforced by an action for breach of a promise.** More importantly, the collateral contract is not caught by the parol evidence rule because it is oral.

If an inconsistency comes from the operation of an exclusion clause in the main contract, **the collateral contract or promise will override the exclusion clause because it is the very thing that induces the injured party to contract.** For example, the promise to you by a parking attendant to park and lock your vehicle when an exclusion clause on the ticket stated 'all care and responsibility by the car park' could be viewed as a collateral promise or contract that would be meaningless if the exclusion clause was allowed to prevail. The parking attendant's statement that the car would be locked as soon as it was moved was the very thing that induced you to enter into the contract. This was really a case about principal and agent, and the ability of an agent to bind their principal. While the attendant's promise was not within his actual authority, it was within his ostensible authority – that is, the principal had, either by words or conduct, led a third party to reasonably believe that the agent had authority to contract on the principal's behalf when this in fact was not the case (we will cover this in more detail in Chapter 14).

Just note that a collateral contract is a contract in its own right and separate from the main contract. This means that if for some reason the main contract is illegal and unenforceable, the collateral contract maystill be enforced. A collateral contract may also be enforced if the main contract is one that is required to be in writing or evidenced in writing and the collateral contract is not.

Reflection questions

Time to take a break. Have look at the questions below and see what you think.

1. Once a collateral contract is established, what does the plaintiff need to show for it to be valid and enforceable?
2. Does a collateral contract or promise override an exclusion clause?

PROBLEM 1

FACTS: You entered into a contract with the defendants for the purchase of a boat. During the course of negotiations, you sought the written advice of the defendants as to what would be a suitable engine for the boat. They commented on three types and recommended one in a letter that included the statement that the boat would have an estimated speed of 23 knots. You accepted this recommendation, but the contract specification and quotation contained no reference to speed. After the motor was fitted, the boat failed to reach the speed estimated by the defendants and you wanted to reject the contract.

ISSUE: Was the recommendation of the speed of the boat important?

DECISION: What do you think? Which of the following three hints below do you pick and why?

HINT: You have three things to consider here:

- You could have made the attainment of speed a condition in the contract, but you didn't.
- You could have made the defendants promise that the boat was capable of achieving 23 km/h, but you didn't. The statement must be promissory, not representational, if it is to be actionable.
- You could have used your own judgment based on what the defendants had said, which is what you did, and that statement was not promissory.

PROBLEM 2

FACTS: You leased a cinema which you decided to sublease to Cineplex for a period of 4

years. The written sublease contained a proviso that you could terminate the agreement at any time by giving 4 weeks' notice in writing to Cineplex. After 2 years you decided to terminate the sublease, which was before the end of the 4 year term. Cineplex then claimed damages for breach of a verbal promise given by you, before the sublease was signed, that you would terminate the lease only if you had been served with a similar notice by the head lessor which you hadn't been.

ISSUE: Can you terminate the sublease? Can you terminate the sublease when the head lessor has not served you with a similar notice?

DECISION: What do you think?

COMMENT: In this case an assurance was given about how a particular clause was to operate. By reneging on the promise, are our actions unconscionable?

How important is the term?

When you enter into a contract you need to understand that a contract can contain both express and implied terms:

- **Express terms** are terms that are incorporated into the contract in writing, orally, partly written and partly oral, or by a sign displaying the terms (such as at a car park). If the contract is important, better to have the terms in writing.
- **Implied terms** are incorporated into a contract by implication and intended to give effect to the presumed intentions of the parties when a contract's express terms have not fully covered the matter (see 'What are implied terms' further down).

It is also important that that you can recognise the different type of terms, and identify whether they are a condition, warranty, an innominate term, a condition precedent or condition subsequent, as well as statutory consumer guarantees that form part of a contract. The remedies available to the injured party differ according to the type of term you are dealing with.

What types of terms are there?

In brief

Features of terms

TERM	DESCRIPTION	EFFECT
Condition	A stipulation or term that is vital to the contract and must be fulfilled by one or both parties and which can be express or implied.	Breach entitles the injured party to terminate (but any rights accrued up to that time remain outstanding) or affirm and/or sue for damages.
Warranty	A minor or non-essential term and collateral to the main purpose of the contract. It is not the same as a warranty for goods.	Damages only. Failure to comply is generally considered non-essential and not grounds to terminate unless the term is essential, such as 'time is of the essence'.
Innominate/ intermediate term	A term that sits between a condition and a warranty. The court focuses on the seriousness of the effects of the breach.	If the breach has a serious effect, the plaintiff can elect to affirm or rescind. Damages are available in either case.
Condition precedent	A term that **must** be satisfied **before** a contract can come into existence.	**No enforceable contract exists.** No remedy, as no breach.
Condition subsequent	A term in an existing contract which provides that the contract will terminate on the happening of a particular event.	**Terminates existing contract.** No remedy, as contract validly terminated.

What is a condition in a contract?

A c**ondition is a term that is vital to the contract**. The parties consider it so important that its non-performance may be considered by the injured party as amounting to substantial failure to honour the contract at all and may be regarded as grounds for **terminating the contract** (but note that any obligations still outstanding at the date of termination continue)**and/or suing for damages.**

What is a warranty?

The parties consider a **warranty** to be **a term of lesser importance**to the main purpose of

the contract. If it is breached, injured parties must still perform their part of the contract, but they only have the right to **sue for damages**for any loss that they may suffer as a result of the breach.

How do you tell the difference between a condition and a warranty?

Whether a term is a condition or a warranty depends on the intention of the parties, looking at the contract as a whole. A problem is that the parties rarely indicate whether a term is a condition or a warranty, or something else. And even if they do, there is no guarantee that the courts will accept what they say.

In some cases, a party may expressly provide that a particular promise is essential to the contract – for example, by a stipulation that it is the basis or the essence of the contract. However, in the absence of an express provision the question is one of construction for the court, once the terms of contract have been ascertained. In trying to decide on the importance of a term, the courts may:

- **look at what effect the breach had** on the contract – if the breach has had a serious effect, it could be treated as a condition; or
- **apply an objective test,** looking at the case as a whole and considering the importance of the broken stipulation as an inducement to the plaintiff to enter into the contract. **Is the stipulation essential to the contract?** If the answer is 'yes', then it is a condition and if 'no', then it is a warranty.

Business tip

Parties who wish to have a degree of certainty that a breach of a particular term will terminate an agreement should spell out the effect of such breach in their agreement, and the court will then give effect to their intention. If the parties rely on expressions such as 'condition' and 'warranty', whether a term is a condition, a warranty or an innominate term will ultimately depend on how the courts interpret the term.

Note it can be difficult in determining whether a term is a condition or a warranty. In each case, the court looks at the contract as a whole and considers whether the promise was

so important to the promisee that they would not have entered into the contract unless there had been an assurance of a strict or substantial performance of the promise, and this was apparent to the person making the promise at the time. If the breach does not have a serious effect on the contract, then it will be treated by the courts as a warranty and the injured party will be entitled only to damages.

What are intermediate or innominate terms?

It may happen that a term cannot be classified as a condition or a warranty until **after a breach of contract** has occurred. The courts have identified a further class of terms that fall between conditions and warranties called intermediate or innominate terms.

Here the court focuses on **how serious the effects of the breach**are on the contract, rather than attempting to classify the term as a condition or a warranty. The question to consider here is whether the breach has deprived the innocent party of **substantially the whole benefit**that they should have derived from the contract?

Labelling a term as a condition or warranty does not necessarily determine its legal effect. In an English case called *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26, Hong Kong Fir owned a ship, which it chartered to Kawasaki for 2 years. The contract required Hong Kong Fir to provide a vessel, but Kawasaki forgot to include a term in the contract providing the ship should be seaworthy. When the ship arrived, it was unseaworthy and took 15 weeks to get it ready to sail, depriving Kawasaki of a substantial part of the benefit of the contract. The court held that Kawasaki could not repudiate the contract, as seaworthiness had not been included as a condition of the contract. Nor were the delays – 15 weeks of a 2 year contract for service – considered so great as to frustrate the commercial purpose of the charter. The defendant should have sought damages.

As Hong Kong Fir Shipping illustrates,**nothing less than a serious breach entitles the innocent party to treat the contract as at an end**.

What is a condition precedent?

There are two possible meanings that can be given to the term condition precedent:

- As a **condition precedent to the formation or existence of a contract** – for example, acceptance ‘subject to finance’ or, ‘subject to the approval of a third party’. In this case, unless and until the condition is fulfilled – that is, the finance or approval are forthcoming, there are no enforceable rights between the parties.
- Was the term a condition precedent to the **performance of a party’s obligations** under a contract? For example, was there an obligation on the buyer not only to do all

that was reasonably necessary to fulfil the condition but also to complete within a reasonable time?

Non-fulfilment entitles the party not in breach to terminate. For example, in the case of a sale of a property, you will often find the potential buyer including in the contract a term stating that the sale is subject to the buyer completing the sale of their existing property or getting finance approval in a reasonable time. In this case there is a binding contract, **but** performance depends on the fulfilment of the condition precedent.

What is a condition subsequent?

A condition subsequent is a **term in a contract** that must be complied with **after the contract is made** or the other party can terminate the contract for non-compliance – for example, the death of one of the parties, or the seller of a vehicle tells the buyer that if they are not completely satisfied to return the car in 30 days and get their money back.

What are implied terms?

In addition to its express terms, a contract may contain a number of terms that the parties or the courts may 'read' into the contract. These are called 'implied terms' and to be implied into a contract, the term **must satisfy 5 conditions**set down by the Privy Council in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1978) 52 ALJR 20:

- reasonable and equitable; and
- necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; and
- so obvious that 'it goes without saying'; and
- capable of clear expression; **and**
- not in contradiction of any express term of the contract.

In brief

Types of implied terms

TERM	DESCRIPTION
Custom or usage	Where there is an established custom or practice, and it could be assumed that the parties must have contracted with that term in mind.
Statute	Certain statutes may imply terms into contracts.
By the courts	Terms may be implied by the courts to cure obvious omissions or to give the contract 'business efficacy'.
Uncertain	Where the parties have had prior dealings, the courts may fill in the gaps to give the contract 'business efficacy'.
Meaningless	Terms for which the meaning cannot be ascertained and which the court will sever if possible.

Can terms be implied by trade custom or usage?

Where there is no express provision to the contrary in a contract, and the trade custom or usage relied on is so well known by everyone in that business they would have assumed it to have been included as a term in the contract, then it may be implied by the courts by considering:

- Whether there is the existence of a custom or usage – a question of fact.
- Evidence that everyone in the trade would reasonably be assumed to have imported that term into the contract.
- A term will not be implied on the basis of custom if there is an express term to the contrary; **and**
- That the term is of such notoriety in the trade that it was reasonable to assume that all persons dealing in the trade could easily ascertain knowledge of the custom.

Can terms be implied by statute?

A number of statutes imply terms into a contract. When considering the operation of such terms, it is necessary to consider to what extent the parties may be able to modify or exclude them. For example, look at the *Fairness of Transactions Act 1993* and the *Goods Act 1951*.

When will the courts imply terms?

In some cases, the intention of the parties is plain but, owing to an oversight on the part of the parties, the contract may not give effect to what the parties wanted or understood. Where this occurs, the judge may imply terms into the contract in order to overcome this omission and give effect to the intention of the parties – to give 'business efficacy' to the contract.

What happens where the terms are uncertain or unclear?

If there have already been dealings between the parties, or there are expert witnesses who can give evidence to fill in missing pieces in the contract in order to interpret the parties' intentions, the courts **may**be prepared to enforce the contract. For example, if there have been prior dealings between the parties, and the fact that reference could be made to what was normal business practice, the contract may be enforceable as the courts accept that there is sufficient intention present to bind the parties.

If there are no past dealings and no expert witnesses to assist the court in trying to determine the intention of the parties, the court will have little alternative but to strike the contract down as **void for lack of certainty**.

The court will imply a term by reference to the imputed intention of the parties only if it can be seen that such a term is necessary for the reasonable or effective operation of the contract. Otherwise, it will strike down 'the contract' on the basis that there is no real agreement between the parties.

What are meaningless terms?

Unlike an uncertain term, where there is no real agreement, with **a meaningless term the parties have agreed on something but it is unclear what it means.** The difficulty is that the terms may be worded in such a way that a reasonable person would be unable to determine their meaning. In such a case, **the validity of the contract will depend on whether these terms can be severed from the rest of the contract and still leave it valid.** This is a matter of the construction of the whole contract.

If the courts cannot sever the term from the contract, then the contract will be found to be void for uncertainty. However, it should be noted that if goods or services have already been provided, the law of restitution provides that they must be paid for at a reasonable price.

Business tip

Guide to construing the words of a contract

When construing the words of a contract, regard should be had to the following principles:

- The meaning of the word/s is to be determined in the context of the contract as a whole
- With the interpretation of commercial contracts, a common-sense approach should be adopted
- It is presumed that the parties did not intend the terms of their contract to operate in an unreasonable way
- In determining the meaning of words, consider the legal effect of the term

What happens if the terms are ambiguous?

In the case of an ambiguous term that could have two primary meanings, each of which could be adopted without distortion of the language, it does not necessarily mean the contract is void for uncertainty. The court will pay regard to direct evidence of the intentions of the parties, including evidence of the circumstances surrounding the making of the contract and the admission of extrinsic evidence to resolve an ambiguity.

The extrinsic (including parol) evidence supplements or explains the written instrument and may include direct evidence of the intention of the parties, including evidence of negotiations between the parties, previous dealing between them, and direct evidence as to what was in their minds at the time.

Reflection questions

Time for a break. Before you do, scribble down your thoughts to the questions below.

1. Explain why it is important to know what type of term/s are contained in a contract?
2. How do the courts decide on the importance of a term?
3. What is the difference between a condition precedent and a condition subsequent in a contract? Explain, giving an example of each.

PROBLEM 1

FACTS: Poussard was engaged to play a leading role in an opera which was to last about three months. Owing to delays on the part of the composer, final rehearsals did not take place until the week when the first performance was to take place. In the final few days before the first performance, Poussard fell seriously ill and it was not clear how long she might be sick for. A substitute singer had to be found or the show faced financial ruin. Poussard was unable to take part in the show until a week after the season had commenced. The producers, who had been forced to find a substitute, then refused her services.

ISSUE: Was Poussard's failure to attend the opening night sufficiently serious to entitle the producers to sack her? Was this a breach of condition or a warranty?

DECISION: Would you sack her?

HINT: Do you think the failure on Poussard's part to perform on the opening night went to the root of the contract and permitted the producers to fire her.

PROBLEM 2

FACTS: Bettini, an experienced opera singer, entered into a contract with Gye to sing in his opera. As part of the agreement, he agreed to arrive 6 days before the start of the opera for rehearsals two days in advance. Gye attempted to use the non-attendance as an excuse to terminate the contract.

ISSUE: Was the late arrival a sufficiently serious event to warrant terminating the contract? Again, was it a breach of a condition or a warranty?

DECISION: What would your answer be here? The same as question 4 above?

HINT: The effect on the contract was only partial.

What are exclusion clauses or terms?

It is not unusual in business to find a party attempting to limit or exclude their liability in

certain situations by including an **exception, exemption** or exclusion clause(also known as a 'limitation of liability' clause) in the contract. Such clauses are frequently found in 'standard form' contracts.These are contracts that incorporate terms of a standard nature, often in fairly wide terms, applicable to all persons making a particular type of contract – for example, when making a booking contract with an airline, a bus company or the railway for a holiday, or parking your car in a car park. **Their purpose is to limit the liability of the person inserting the clause.**

It is a matter of some practical importance to know whether or not these terms or clauses form part of the contract. If they do, they bind the person entering into the contract, even if that person does not understand the terms or has not even read them.

At common law, a party is bound to exercise reasonable care over the person or property of another that has been entrusted to them under a contract. Failure to exercise reasonable care may leave the entrusted person open to a claim for damages, and it is this type of action that an exemption clause seeks to prevent. **Its purpose is to relieve one of the contracting parties from liability that they would otherwise have.**

The courts look at exclusion clauses very critically. Often the parties are in unequal bargaining positions, and this is particularly the case where consumers are concerned. There is often very little opportunity for a consumer to negotiate the terms or to read (or understand) the 'fine print' on the document they receive or sign.

In the case of commercial contracts, the courts are more likely to assume that the parties were in equal bargaining positions and able to seek legal assistance. However, in either case the**effectiveness of an exclusion clause is a matter of construction of the contract as a whole, taking into account the bargaining position of the parties.**

In addition to the position at common law, consideration also needs to be given to the impact that the *Fairness of Transactions Act 1993* may have on the inclusion of exclusion terms in consumer contracts, given its emphasis on fairness in ss 1 and 4.

What is the legal position where there is a signed document?

It has to be established at the outset that the particular document relied on as containing the exclusion clause, which is often a ticket or receipt, is **an essential part of the contract**and not a mere acknowledgment of payment for a contract already made.

If the document is found to be an integral part of the contract, much then depends on whether or not it was signed by the acceptor. If you have to sign a document, do you read it carefully before you sign it? Let's say you buy a washing machine from Graucob. You have

it delivered and you are now running late for work, so you sign a document headed 'Sales Agreement' without first reading it. It contained the following clause:

> *'This agreement contains all the terms and conditions under which I agree to purchase the machine specified above, and any express or implied condition, statement or warranty, statutory or otherwise, not stated herein is hereby excluded…'*

When the machine failed to work properly, you brought an action against Graucob. As there was no fraud or misrepresentation, at common law you are bound, irrespective of whether you had read the document or not. You **might** have statutory remedies under the *Goods Act 1951* and the *Fairness of Transactions Act 1993* but what a pity you didn't read the Sales Agreement first.

Just remember that a party signing a document knowing that it might have contractual terms is generally bound by those terms, whether they have read the document or not. It is worth noting, however, that this type of exclusion clause today may contravene s 4 of the *Fairness of Transactions Act 1993*.

What if there is evidence of fraud or misrepresentation?

If fraud or misrepresentation can be established, the person signing will not be bound. If you are asked to sign a receipt, always ask 'what is the purpose of me signing this document?' In a consumer transaction it will often be intended to exempt the seller from liability in which case you had better hope that the *Fairness of Transactions Act 1993* can help.

What if is there is no evidence of fraud or misrepresentation?

If you sign a document containing an exclusion clause you **may**not be bound if you had reasonable grounds for believing that the document was not contractual. In the case of contractual documents that contain onerous terms, if such terms are to be effective then they must be brought to your notice if you are the party against whom they are to be enforced. This must be done before or at the time the contract is created.

However, where there is no disparity in knowledge or bargaining power, and no misrepresentation, fraud or duress, your**signature is a very strong indication of intention to be bound** because of the importance the court places on you signing a document. It is difficult to argue unfairness to trigger the *Fairness of Transactions Act 1993*.

What happens with unsigned documents?

Where the document is unsigned, **the question is whether you, if you are the 'customer', knew of and consented to the exclusion clause.** If they did not, would a reasonable

person have regarded the document as one that would contain contractual terms and not represent a mere receipt or acknowledgment?

Have reasonable steps been taken to give sufficient notice of the term?

Where the document is neither a receipt nor an acknowledgment – for example, tickets for rail, sea or air journeys – should the customer have constructive notice of onerous clauses in the document? **Has the defendant taken reasonable steps to give sufficient notice of the term to this class of persons? This is a question of fact**in each case.

Reflection questions

Time for another break. Before you do, have a read of these 2 questions and see whether you think the exclusion clause is effective. It could be you one day dropping off your laptop or going on cruise.

1. **FACTS:** You left your laptop with Browne Computer Services for repairs to the hard drive. When you came to collect the laptop, you noticed the screen was cracked. You claimed damages for breach of contract, and the business relied on provisions printed on a docket, handed to you when you left the laptop, which read: *'No responsibility is accepted for loss or damage to laptops through any cause whatsoever'.*

   ISSUES: What would be reasonably understood as being the purpose of the docket? Did Browne Computing make you aware that the docket might contain conditions?

   DECISION: What do you think? Would your answer be any different if you had to sign the docket?

   HINT: In this case, would you have a remedy under the *Fairness of Transactions Act 1993*?

2. **FACTS:** The Baltic Shipping Company owned the cruise ship Mikhail

Lermontovwhich, eight days into her cruise, sank in New Zealand waters due to the negligence of the pilot. As a result of the ship sinking, you lost all your luggage and suffered personal injury. The booking form had stated that the contract for carriage for travel would be made at the time of the issuing of tickets. Some six weeks after payment for the cruise and two weeks before departure, a ticket containing conditions limiting the defendant's liability for loss of baggage or personal injury was issued to you.

ISSUE: Could the shipping company rely on the limitation clause in the ticket to limit their liability?

DECISION: What do you think?

HINT: Was there a total failure of consideration? Why is that important? And what was the object of the voyage?

Business tip

If the condition is particularly onerous or unusual, and one that would not be generally known to the customer, the party seeking to enforce the condition mustshow that it had been fairly and reasonably brought to the customer's attention – for example, by displaying a large sign in a prominent position or by marking the condition in red on a contract.

As a general rule, **a party will be bound by displayed terms if they have either knowledge or reasonable notice of the terms, regardless of whether they have read them or not.** If you go to park your car in a car park and you get a ticket from the machine, do you read the ticket or do you just check the time on it? Should the car park give reasonable notice that a ticket contains an exclusion clause? What is reasonable notice? Printing the clause in red ink with a red hand pointing to it?

If there are unusual conditions, these must be brought to the customer's notice or they may be struck down as being unconscionable.A good example is an unreasonable clause.

Business tip

Where onerous or unusual terms form part of the contract, special notice should be drawn to them. It is not sufficient to incorporate an onerous condition on a delivery note without first discussing with, or drawing to the attention of, the customer the fact that a heavy penalty will be imposed for a breach of the term. **The crucial test is whether reasonable notice of the term has been given on or before the contract was created.**

Where the contract has been made, any subsequent introduction of an exclusion clause will be ineffective and the exclusion clause will not operate as the termsmust be introduced while the contract is being formed so that the other contracting party has the opportunity of accepting or rejecting them.

Business tip

Always be conscious of dates and note carefully when a contract appears to have been made and the date when the exclusion clause first appeared in the contract. Was it before or after the formation of the contract? If it is at the pre-contractual stage, has reasonable notice of the term been given (as it may still not be effective)? But if it

How do you interpret an exclusion clause?

Assuming that the exclusion clause has been properly incorporated into the contract, three possible approaches to interpretation can be identified:

- **Strict construction against the party relying on the clause or term.** Where the exclusion clause has been correctly incorporated into the contract it will be strictly construed against the party who attempts to rely on it. This is known as the *contra proferentem* rule. The clause will be 'read down' by the court unless it specifies the type of liability to be covered and any ambiguity will be resolved in favour of the injured party.
- **The 'four corners' rule.** The 'four corners' rule of interpretation states that exclusion clauses do not apply to actions outside the contract. They will not apply to situations involving deliberate breach, or

for conduct that is outside the objects of the contract.

- **Interpretation according to the express agreement. the effectiveness of an exclusion clause is purely a question of construction of the contract as a whole** in each case. Is the term or clause wide enough to exclude an action for the alleged breach?

is post-contractual, the clause will not operate.

What is the position with commercial contracts?

Commercial contracts may be allowed to stand because of the equality of bargaining positions that can exist between the parties (although the presumption of equality of bargaining positions in commercial contracts is a rule of construction based on the presumed intention of the contracting parties in each case).

How are indemnity clauses and guarantees dealt with?

They are to be construed strictly in the context of the contract as a whole. If the indemnity clause or guarantee contains any ambiguity, it will be construed in favour of the party providing the indemnity.

Reflection questions

Take another break. Before you do, have a read of these three problem questions and see whether you think the exclusion clause is effective. Each one is based on an actual case.

PROBLEM

FACTS: Visiting Sydney, you decide to take a ferry from Circular Quay to Manly. The ferry company operated a service between Circular Quay and Manly in Sydney. Entry to the ferry is through a set of turnstiles, operated by payment by cash (K7) or card at a vending machine next to the turnstiles at Circular Quay. Above the turnstiles was a sign stating: *'A fare of K7 must be paid on entering or leaving the wharf. No exception will be made to this rule whether the passenger has travelled by ferry or not'.* You paid K7 to gain admission and,

finding that you had just missed the ferry, attempted to leave without paying another K7. You were stopped and forced to pay by the attendants.

ISSUE: As this is your first time to Sydney, could knowledge of the terms and conditions of travel be implied? Would your answer be different if you had used the service on a number of occasions while in Sydney?

DECISION: What do you think?

PROBELM

FACTS: You hired a bike from John Warwick & Co. The contract contained a clause stating: *'Nothing in this agreement shall render the owners liable for any personal injury to the riders of the machines hired'*. The bike was supplied with a defective seat, which caused you to fall off and injure yourself. You sued John Warwick in contract for breach of warranty on the basis that the bike was not fit for the purpose for which it was hired, and in tort for negligence in supplying a defective bicycle.

ISSUE: Did the exemption clause operate to protect the defendants in both contract and negligence? If the clause had read: 'Nothing in this agreement shall render the owners liable for any personal injury to the riders in negligence or contract of the machines hired', would that make any difference to your answer?

DECISION: What do you think?

NOTE: In this case you could argue John Warwick owed concurrent duties in contract and tort (negligence) to you. Read the exemption clause carefully and think about what it covers.

PROBLEM

FACTS: Before you parked your car at Eazi Car Park, you were issued with a ticket that contained on the back of it the following clause: *'Eazi Car Park the Council does not accept any responsibility for the loss or damage to any vehicle . . . however such loss . . . may arise or be caused'*. It also stated: 'This ticket must be presented for time stamping and payment before taking delivery of the car'.

A car park attendant allowed a thief to driveaway in your car after the thief claimed that he had lost his original ticket and presented another ticket on which was written a different registration number from that of your car. You sued for breach of contract and in the tort of detinue (this is a common law action available to a person claiming either the return of the goods wrongfully kept by another or their value).

ISSUE: Was the car park attendant, in allowing a thief to take the car, acting outside the terms of the contract so that the exclusion clause didn't operate?

DECISION: What do you think?

HINT: The validity of the exclusion clause is a matter of construction. Exactly what were the terms of the contract.

NOTE: This was actually a bailment case where the bailee (Eazi Car Park) was seeking to rely on an exclusion clause

Can you delete unreasonable terms?

Where the court is faced with a wholly unreasonable term, the position of the common law appears to be that the court has no power to delete that term. Sections 4 and 5 of the *Fairness of Transactions Act 1993* attempt to remedy what was an unsatisfactory common law situation by enabling a court to review an unfair contract.

Business tip

A precisely drafted exclusion clause in a business contract may protect a party relying on it as long as it can be shown on a proper construction of the contract that the parties intended not to be liable on the happening of the events envisaged in the contract. But note that the clause generally will not operate:

- if there is any deviation from the contract
- if the conduct of the party relying on the clause falls outside the scope of their obligations under the contract
- if it is an unfair term of a consumer or small-business contract and caught by s 4 of the *Fairness of Transactions Act 1993*.

What is the standing of third parties?

Third parties will be protected because they are not a party to the contract unless it is clear in the contract that they are to be covered.

A third-party exemption clause (known as a 'Himalaya clause', from the name of a ship) can **provide protection to a third party who is not a party to the contract**and is widely used in transportation contracts. For example:

> *'The company will not be responsible for and shall be exempt from all liability in respect of any injury to the person of any passenger'.*

For a third party to gain the protection of an exclusion clause (remember that a third party is not a party to the contract), they **must satisfy the 4 conditions**:

- the contract makes it clear that it was intended to benefit third parties; and
- it was clear that the defendant was contracting for itself and third parties; and
- the defendant had the authority of the third party to make the contract on their behalf – as this is an agency relationship, ratification can take place after the contract has been made; **and**
- consideration has moved from the third party – the performance of an existing duty is good consideration if it is owed to a third party.

Reflection questions

Take a break and have a look at these 3 questions and think about how you would answer them.

1. Explain the operation of the *contra proferentem* rule. Is such a rule defensible today?
2. In order for a party to rely on an exclusion clause, what must they show?
3. In the case of a signed contract, can the party signing limit their liability in both contract and tort?

Key points

An understanding of the following points will help you to better revise material in this chapter.

- **What is the difference between a representation and a term?**A **representation**is a statement of fact, made by one party before or at the time of the making the contract, which leads the other party to enter into the contract. The representation is pre-contractual and **does not**form part of the contract, and is**not intended to be legally binding.** Thus, they are not actionable in contract law.
    - A **term**, on the other hand, is a statement of fact that is intended to be legally binding and is part of the contract.
- **What is the importance of a collateral contract?**Where a pre-contractual statement is not a term of the main contract, it may still have contractual effect as a collateral contract, thus providing the injured party with a remedy. Such a contract has an independent existence from the main contract and may be enforced by an action for breach of a promise. More importantly, the collateral contract is not caught by the parol evidence rule because it is oral.
- **What types of terms are found in a contract?**Terms found in a contract will either be express or implied. An express term is either oral or written, while implied terms are those terms 'read' into the contract by the parties or the courts.
- **What is the difference between a conditions warranty and innominate term?**A condition is a term that is essential to the contract, breach of which allows the injured party to rescind or seek damages (or both). A warranty is a term of lesser importance and allows the injured party only to recover damages. An innominate term is an intermediate term that falls between a condition and a warranty and may allow the injured party to terminate the contract.
- When are terms implied into a contract, and what is their effect? Five conditions must be satisfied for a term to be implied into a contract:
    - the term must be reasonable and equitable
    - necessary to give business efficacy to the contract – that is, produce the result that the parties intended, so that no term will be implied if the contract is effective without it
    - so obvious that 'it goes without saying'
    - capable of clear expression; **and**
    - not in contradiction of any express term of the contract. *Note:* Implied terms are intended to give business efficacy to the contract and may be implied from custom or usage, by statute, previous dealings or by the courts.
- **What is an exclusion clause, and what is its effect on a contract?** An exclusion clause, also known as an 'exemption clause', 'exception clause' or 'limitation of liability clause', attempts to limit or exclude the liability of the person inserting it. In the case of signed documents, unless fraud or misrepresentation can be established or there is statutory protection available, the signor is bound. In the case of unsigned documents, would a reasonable person have expected to find such a clause in that type of document? Have reasonable steps been taken to give sufficient notice of the term

and, if not, can they be implied by trade usage or custom trade? If the clause has been properly incorporated into the contract, the courts will construe the clause *contra proferentem (*strictly against the party relying on it). Generally, a third party is not protected by an exemption clause unless there is express intention by the contracting parties to cover third parties. If an exemption clause excludes liability for all terms in a contract, there is nothing left in the contract and it will be struck down by the courts.

12.

DISCHARGE AND BREACH OF CONTRACT

Learning Objectives

On completion of this Chapter, you should be able to:

- Discuss the doctrine of privity of contract.
- Describe the circumstances in which novation and assignment of rights and liabilities can change contractual obligations.
- List how a contract may be ended.
- Explain the situations in which a contract may be breached.
- Explain the common law remedies for breach of contract.
- Explain the steps in determining an award of damages at common law.
- List the main types of equitable remedies and explain where they may apply.

Key terms

You will notice these key terms, which are mentioned throughout the chapter, to help you to better understand and remember the material:

- **Actual breach:** failure at the time required by the contract.
- **Anticipatory breach:** the threatened failure to perform and can occur expressly or by implication.
- **Anton Piller order:** an order that is available only where it can be shown that the defendant has incriminating evidence that is necessary to the plaintiff's case and which may be destroyed before 'discovery' can be made.
- **Assignment:** transfer.
- **Condition precedent:** a precondition that, depending on its analysis, stops a contract from coming into existence until the occurrence of some specified event.
- **Condition subsequent:** a term of the contract that must be complied with after the contract is made, that is, in the future, or the other party can terminate for

non-fulfillment.

- **Damages:** compensation in monetary form for the loss suffered by the plaintiff, which puts the plaintiff back in the position they would have been in had the breach not occurred.
- **Divisible contract:** a contract that is capable of being divided into separate parts.
- **Exemplary damages:** punitive damages.
- **Expectation damages:** (also known as 'expectation losses') arise from your expectation of prospective benefits arising out of or created by the contract.
- ***Force majeure*:** clause operates to suspend a party's obligations under a contract when an event occurs that is outside their control, causing them to be incapable of carrying out their obligations under the contract for the period of the event.
- **Frustration:** the discharge of a contract rendered impossible to perform because of the operation of external factors beyond the contemplation of the parties.
- **Injunction:** a discretionary remedy in equity restraining a party from doing something.
- **Innominate term:** a term between a condition and a warranty and is used by the courts when it can't be shown that a term is a condition or warranty.
- **Legal tender:** currency that may be lawfully tendered in payment of a debt.
- **Liquidated damages:** an agreed sum based on a genuine pre-estimate of the actual loss that would be suffered by the plaintiff in the event. of a breach of the contract.
- **Mitigation:** the steps taken by the plaintiff to minimize their loss.
- **Nominal damages:** compensation awarded where the plaintiff's rights have been infringed but they have suffered no actual loss.
- **Novation:** the substitution of a new contract for an old one; the new contract extinguishes the rights and liabilities that were in effect under the old contract.
- **Ordinary damages:** the amount awarded by the court on its assessment of the loss suffered by the plaintiff as a result of the breach.
- **Penalty:** in contract, a damages clause that is not a genuine pre-estimate of the actual damage or loss suffered by a party as a result of the breach.
- **Privity of contract:** only those who are a party to the contract are affected by it.
- **Quantum meruit:** an equitable remedy that means as much as a person has earned or as much as that person deserves.
- **Rectification:** an equitable remedy to correct an omission in a written contract that both parties had failed to correct by mistake at the time of making the contract.
- **Reliance damages:** (or 'wasted expenditure damages') arise from expenditure incurred by you relying on the defendant's promise and which is wasted because

of the defendant's breach.

- **Rescission:** a common law or equitable remedy that entitles the injured party to elect to rescind the contract and restores the injured party to their pre-contractual position.
- **Specific performance:** an equitable remedy compelling a person to carry out their contractual obligations where damages would be an inadequate remedy for breach of the agreement. It is not obtainable for contracts of personal service.
- **Unliquidated damages:** (also called 'general damages') damages for a loss, where the value of the loss cannot be accurately determined or exactly calculated.
- **Waiver:** one party leads the other to reasonably believe that strict performance will not be insisted on.
- **Warranty:** a term of a contract that is of lesser importance than a condition and for which an innocent party can only get damages. They cannot terminate the contract.

Introduction

Well done. This is the last chapter on Contract Law. You now know what is involved in creating a contract, how to determine its validity, and what are the terms of the contract that the parties have agreed to. However, this is not quite the end of the story. It is not unusual for one of the parties to want to assign their rights or obligations under the contract to a third party. Also, under what circumstances can a contract be ended? And what remedies are available to an innocent party if the other party breaches the contract?

In this chapter we will begin by looking first at the position of third parties and how they can acquire rights and incur liabilities under a contract before moving on to the circumstances under which the obligations of the parties to a contract can be discharged or dissolved, including the issue of breach and remedies at common law and equity. We finish with a brief overview of ethical considerations in contract law.

Section 1: Privity of contract

A basic rule of contract law is that only the parties to a contract can:

- acquire rights under it, **and**
- incur obligations under it (the doctrine of privity of contract).

The doctrine of privity *only* applies to contractual rights and obligations for the immediate parties to the contract. A point to remember about contracts is that they are considered to be private arrangements between the parties (the offeror and the offeree) and that the arrangements that they have made only affect them.

Other people who are not parties to the contract, that is, third parties or strangers, cannot acquire any rights or incur any liabilities under the 'contract'. Remember that the basis of a contract is the 'bargain' that the parties have struck between themselves, where each party has bargained for or given something in return for the promise or performance of the other party. However, this may produce unfortunate consequences for a person who was not a party to the contract, but for whom the contract was intended to benefit.

While no right of action in a contract exists against a person who is not a party to a contract, a third party who induces a breach of contract may find that they have committed a tort called inducement of breach of contract (an economic tort).

What is an assignment?

The term 'assignment' in contract law is a term frequently used by contracting parties in commercial contracts where there is a transfer of rights, obligations, or property from one party (the '*assignor*') to a third party (the '*assignee*' who was not a party to the original agreement). For the assignment to be enforceable, the original parties to the agreement must consent to the assignment.

The effect of assignment is that the assignor is no longer entitled to any benefits under the original agreement because they have all been passed to the assignee but check that there is not a negative clause that restricts the original parties' rights to assign.

Common examples where you might encounter an assignment is in an asset sale where a corporation might sell part or all of its company, where a contractor subcontracts their work, or a borrower offers as security to a lender an interest in their assets.

Can you assign rights?

As we noted above, generally, only the persons who are parties to a contract can acquire rights and incur liabilities under it: *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [19156] AC 847. Strictly speaking, it is not possible at **common law** for a third party to overcome the doctrine of privity. However, there are some exceptions to the privity rule including agency, assignment and novation, rights held on trust for a third party, leases, estoppel, and unjust enrichment. **Equity**,on the other hand,*permits the assignment*

of contractual rights, including debts. An equitable remedy is not available if the contract requires the performance of a personal service.

Can you assign liabilities?

Generally, a party who has contracted to perform obligations (liabilities) under a contract cannot transfer those obligations to another. The promisee cannot be forced to accept performance or a promise of performance from any person other than the promisor.

However, if the parties to the contract consent, liability may be transferred by way of 'novation'. Generally, an assignor who has contracted to perform obligations (liabilities) under a contract cannot transfer those obligations to another unless the non-transferring party and the potential assignee agree. The parties should then enter into a novation agreement (which is a new contract between the non-transferring party and the assignee).

Section 2: What are the different methods of discharge of a contract?

What amounts to performance?

Performance is how most commercial contracts are discharged. A party's duty under a contract is to discharge their obligations, or their promises, in full, that is, by total performance. Once they have done that, they are excused from further performance under the contract.

Performance may be:

- **actual performance:** where the promises by the parties under the contract have been properly performed. This rule is strictly interpreted at common law. If the variation is only minimal or trivial, then generally the courts will not worry about it. But each case is determined on its facts, and in each case, the question to ask is whether there has been a substantial departure from the contract. In the English case of *Re Moore & Co Ltd and Landauer & Co* [1921] 2 KB 519 an order was placed for canned fruit in cases of 30 tins but when the goods arrived, the correct quantity of tins arrived but they were packed 24 tins per case. The buyer was entitled to reject the order as the packaging method was an essential part of the contract description.

Does the decision in Re Moore & Co Ltd and Landauer & Cosound trivial? In this case, think about the storage costs and the profit margin. If cases containing 24 tins take up more

storage room doesn't that add to the buyer's costs? And if the profit margin is small, the extra storage space could turn a profit into a loss.

- **partial performance:** where there has been a partial performance, payment does not automatically follow unless:
  - the contract is divisible, that is, capable of being divided into separate parts which is a question of construction
  - there has been a free and willing acceptance by the party receiving the benefit
  - that there has been substantial performance, **and**
  - the actions by the non-performing party prevent performance – for example, in building contracts where work and payment are done in stages.

If the contract **is divisible**, that is, it can be divided into parts which is atypical of many building contracts, it may be possible for the builder to seek payment for the work already done (called a **quantum meruit**claim or 'what the person deserves'). This is based on an implied promise to pay a reasonable sum for work done.

If the contract is **not divisible**, that is, it is entire and cannot be divided into parts, entitlement to payment only happens upon completion of the task. The reason is that the consideration for the right to demand payment is based on the promise to complete the work. In this type of case, where there is still an express contract in force to pay the full amount, a quantum meruit claim will fail because the **express promise takes precedence** over the implied promise to pay a reasonable sum for work completed.

What if there is a free and willing acceptance of partial performance by the party receiving the benefit? In this case, the parties are agreeing to abandon their original agreement and substitute a new agreement. This is based on the partial performance of the original contract and the payment of a lesser amount than would have been due under that contract. But note, if the party accepting the changed circumstances has no option but to accept, then there is no free and willing agreement and therefore no acceptance of partial performance.

If one party is **prevented**from carrying out their part of the contract, the other party may regard the contract as at an end. But the party being prevented from performing will be released from any further obligations and can repudiate the contract, and/or claim damages for breach. If work has commenced under the contract but has not been completed, they may claim on a quantum meruit.

If the **breach is minor**, so that the cost of rectification is small when compared with the contract price, the **doctrine of substantial performance**may still permit the defaulting party to obtain the contract price. This is a *question of fact*and can be assessed by considering the nature of the defects and the difference between the cost of rectification and

the contract price, the benefits obtained by the owner, whether the work is entirely different from that contracted for, and whether the contractor has abandoned the job.

In an ordinary**lump sum contract**, unless there is a clause in the contract to the contrary, a party cannot refuse to pay the full amount because there are defects in the work performed. In this case, the innocent party must pay the contract price less a deduction for the costs of rectification through a set-off or counterclaim.

- **Performance and delivery of goods:** If one party to a contract offers to perform their obligations under the contract and the other party refuses to accept the offer, the person offering the service will be discharged from further performance and the contract dissolved, provided that the attempted performance was *exactly* following the terms of the contract.
- **Performance and the payment of money:** where a contract is to be completed by the payment of money, it is necessary that the payment be made correctly. This may be by way of absolute discharge, that is, payment to the right person, at the right place, at the right time, and by legal tender (which includes a bill of exchange, promissory note, cheque, payment order, or online), as absolute satisfaction of the debt (payment in full). Payment should be made at the creditor's normal place of business and during business hours.

Where payment is by cheque (this is a conditional discharge), the debtor will not receive an absolute discharge unless the creditor has asked for payment by cheque. A cheque is a conditional payment. The bank must honour the cheque before the creditor can get their money. If the creditor didn't ask to be paid by cheque and the cheque is dishonoured, then the creditor can sue on the contract or the cheque.

If payment is made by post, then you need to ascertain whether the post office was an agent for the creditor, or the debtor should the cheque get lost. If the creditor requests payment by post, the post office is the agent of the creditor and if the letter is lost in transit, that is the creditor's problem. If the creditor has not asked for payment to be made by post and the letter gets lost, then it is the debtor's problem.

What is termination?

This is a self-help remedy available to an innocent party and is used if there has been a repudiation of the contract by the other party.

What is mutual agreement?

Here both parties abandon their original agreement while there is still something to be done. There are several ways this could take place including:

- **alteration** is where the parties agree to change the terms of the contract.
- **merger** is where two companies come together and operate as a single legal entity, combining their assets and liabilities.
- **novation** is where a new contract is created between the non-transferring party and the assignee without changing the obligations agreed to in the original contract. The assignor agrees to forgo any rights afforded to them in the original contract.
- **remission** occurs when one party voluntarily agrees to accept a lesser amount or lesser performance of the promise made by the other party – for example, when a creditor agrees to accept less than the full amount they are owed (perhaps to avoid going to court).
- **rescission** is a discretionary remedy in equity used by the courts when they have determined that a reason for one of the parties entering into the contract was unfair. This could be due to mistake, misrepresentation, duress, or error by the other contracting party.

What is repudiation?

Repudiation is where one party to a contract decides to terminate the contract because they no longer wish to carry out their obligations. This often takes place before the repudiating party has breached their obligations. This then leaves the other party with the choice of ending the contract (what is known as an **anticipatory breach**) or continuing and waiting for the repudiating party to fail to carry out their obligations and be in breach of the contract.

What is release?

This is similar to waiver (see below) but here, one party has performed their obligations but the other hasn't. Such a release amounts to a unilateral discharge of the contract and will not be effective unless it is:

- under seal (often referred to as a deed of release); **or**
- supported by further consideration by the party who is yet to complete their obligations; **or**
- subject to the principle of promissory estoppel (which was covered in Chapter 7).

If a third party offers a smaller sum in the discharge of the whole debt, and the creditor

accepts it, the creditor can't then maintain an action for the balance from the debtor because they are bound by the agreement with the third party when they accept the smaller amount in discharge of the whole debt. It would be a fraud on the third party to proceed for the balance owed by the debtor.

How does waiver differ from release?

A waiver of contract occurs when one of the parties to the contract deliberately gives up their rights and leads the other party to reasonably believe that while strict performance can still technically be demanded, it will not be strictly insisted on. To constitute a waiver, the action of the party giving up their rights must be intentional, voluntary, and depend on what is outlined in the contract.

What is accord and satisfaction?

When one party has performed their obligations under a contract and the other has not, the defaulting party can be relieved of their obligations in return for doing something different from what they were bound to do originally (the '*accord*' refers to the **new agreement**and the '*satisfaction*' to the **consideration**for it which will be the performance of the new terms according to the agreement). You will often find an accord and satisfaction occurring in debt negotiations.

What is a substituted agreement?

This applies where the parties wish to continue with their contractual relationship but on different terms. What can be done by the parties with one agreement can be undone by them with another agreement (novation). Interestingly, the new agreement need not be in the same form as the old one, and a written contract, including a deed, can be discharged or varied orally, but make sure that the intention to rescind the original contract is clear.

What is the operation of law?

Here the contract is terminated independently of the wishes of the parties, for example, by bankruptcy, or the death or injury of either party if it is a contract for personal services.

When is time important?

An offer cannot remain open indefinitely and in most commercial contracts there will be a time stipulated, or the offer will only remain open for a reasonable time. The length of

time depends on the type of contract – for example, are the goods perishable and what is reasonable will be determined by the reasonable person or industry practice.

What is the difference between a condition precedent and a condition subsequent?

A **condition subsequent (or a 'reversal clause')** is a term often found in commercial and property agreements or contracts that allow a party to terminate the agreement or contract at any time in the future, even where there may be no fault by the other party. It is a term that is often found in leases and loan agreements, for example, the lender reserves the right to terminate the loan agreement and demand repayment in full if the borrower fails to make their agreed repayments on the loan on time on prescribed in the contract. Just note that in the case of a condition subsequent, the contract is in existence but if the condition is not met, then the contract is void. The onus is on the defendant to demonstrate that conditions subsequent were met.

A **condition precedent** is a term in the contract that*must*be fulfilled *before* the contract can come into existence and is used, for example, in real estate dealings to avoid a binding sale arising without the buyer's express consent during the negotiation process. Two points to keep in mind where a condition precedent is concerned:

- either party can withdraw from the agreement at any time before the condition precedent is fulfilled
- a party that fails to perform the condition precedent is not in breach of contract because there is no contract at this stage.

Does breach end a contract?

Where one of the parties does not fulfill their obligations under the contract within the time required by the contract – for example, by failure to comply with a term of the contract. This is an **actual breach** and can be contrasted with an **anticipatory breach** which is where one party threatens not to perform. An anticipatory breach entitles the innocent party to repudiate the contract, sue for breach immediately, and treat the contract as at an end. It also allows the injured party to mitigate or minimise their loss by making alternative arrangements.

Reflection questions

Take a break a break, but read these questions first, and think about how you could answer them.

1. If the creditor has not expressly indicated that payment must be by post – for example, if the account reads 'Payment within 7 days' rather than 'Payment within 7 days by post' – loss of the letter and its contents is borne by the debtor, irrespective of what past practice has been unless payment is in another city or a great distance away. Explain why.
2. Where there has been partial performance of a contract, does payment still automatically follow for the party in breach? Explain why.
3. The seller agreed to supply 4500 tonnes of wheat to the buyer. The contract allowed a variation of 2% on weight and a further 8% on contract quantity. The seller delivered 25 kg more than the maximum allowed under the contract but never claimed payment for the surplus. Can the buyer reject the whole cargo solely on the ground that the quantity tendered was 25 kg over the contract quantity? Explain.
4. Hoenig was employed to redecorate and furnish Laura's flat for K1500, to be paid as follows: 'Terms of payment are net cash, in three instalments of K300 as the work proceeded; and balance of K600 on completion'. Laura paid K600 to Hoenig. The work was done poorly, and the cost of rectification was K350. Hoenig was not happy. Can he recover the balance of K900 from Laura?

What is the doctrine of frustration?

If a party promises to carry out a particular act, the law will hold them to their promise. This principle is commonly known as the **doctrine of absolute liability**. Because of the potential harshness of this doctrine, the **doctrine of frustration**was developed.

If the object or purpose of the contract is no longer attainable owing to something beyond the control and contemplation of the parties – for example, if you promised to sell your house to a friend and, unknown to either party, the house burns down making the contract impossible to perform, would it be unreasonable to hold the parties to the contract as it is no longer attainable owing to something beyond the control of either party? Just note that the

event has to be unforeseen and make a radical change to the contract making it impossible to perform – it can be said to be frustrated. It is probably best to approach the question of frustration on a case-by-case basis given how uncertain it is.

Note that if a contract has two objectives, one of which becomes non-attainable because of a frustrating event while the other objective can be attained, the contract is not discharged.

In brief

Exceptions to the doctrine of absolute liability include:

- physical impossibility because of destruction of the subject matter
- physical impossibility under a contract of personal service
- change in the law rendering performance impossible
- impossibility due to non-occurrence of event basic to the contract
- where a particular situation ceases to exist.

There are situations where it is *not* possible to plead frustration, and these include:

- the parties have made specific provision in the contract for what might otherwise have been a frustrating event
- it should have been foreseen, but for some reason or another was not
- the frustrating event was self-induced by the party making the plea
- hardship
- inconvenience
- expense in performance, making the contract uneconomic
- impracticability of performance
- the contract has two objectives and only one is non-attainable; **or**
- a temporary injury or incapacity in a contract of employment.

Frustration can arise only where **all** of the following are satisfied:

- an unforeseen event outside the control of the contracting parties (a supervening event) has significantly or radically changed the obligations of the parties from their original intentions; **and**
- neither party caused the 'supervening event'; **and**
- neither contemplated nor anticipated the supervening event, so there was no provision in the contract for it; **and**
- the new circumstances would make it unjust to hold the parties to their original contract because the obligations of the parties have become impossible or radically different to perform.

As noted above, theeffect of a frustrating event is to discharge a contract immediately,but only in the future. The contract is not void *ab initio*, but void only from the time of the frustrating event. For the period that the contract is valid, any obligations that arise must be fulfilled.Money paid under the terms of the contract before the frustrating event occurs (for example, a deposit) cannot be recovered because at the time the money was paid the contract was valid. You would need to establish a total failure of consideration to be able to recover the money.

When can the doctrine of frustration apply?

Delays, hardship, fault, foreseeable events and inconvenience cannot frustrate a contract.

Cases that could involve the doctrine of frustration include:

- Physical impossibility because of the destruction of the subject matter –where the subject matter of the contract, whether for goods or services, is dependent upon the existence of the subject matter, the non-existence of the subject matter after the contract is entered into is sufficient to frustrate the contract.
- Physical impossibility under a contract of personal services –if the promisor dies, becomes sick, or incapacitated then performance is rendered impossible, and the contract is frustrated.
- Change in the law rendering performance impossible,such as the outbreak of war, terrorist attacks, or state intervention such as the imposing of an embargo on the export of certain goods or services of the parties.
- Impossibility owing to the non-occurrence of an event basic to the contract– where the entire basis of the contract is the occurrence of some event that doesn't happen. In the English case of *Krell v Henry* [1903] 2 KB 740 Krell had hired a room specifically to watch the coronation of Edward VII. The procession was postponed because of the illness of the King and Krell successfully claimed the contract was frustrated by the non-occurrence of the event.

  Note that in the case of Krell, the contract only had one objective. But if there are two or more objectives, one of which becomes non-attainable because of an unforeseen or frustrating event, the contract is not discharged.

- Where the particular state of affairs ceases to exist– if the circumstances upon which the contract is based cease to exist or have been substantially changed without the fault of either party, making performance radically different from that originally contemplated by the parties, the contract can be said to be frustrated.

What is the effect of frustration on a contract?

The effect of frustration on a contract is to discharge the contract immediately, but only as to the future. The contract is not void *ab initio* (void from the beginning) but void only from the time of the frustrating event and this distinguishes it from a *force majeure* clause.

For the time that the contract is valid, any obligations that may have arisen must be fulfilled. Money paid under the terms of the contract, such as a deposit, before the contract is frustrated cannot be recovered. Why? Because at the time the money was paid, the contract was valid and if you wish to get your deposit back you are going to have to establish that there has been a total failure of consideration, and you got nothing under the contract. Assistance may be available under the *Frustrated Contracts Act 1978 (NSW)*.

Force majeure

A better option for an innocent party than frustration may be to include a *force majeure* clause in the contract. This relieves a party from performing their contractual obligations and possibly being sued for breach of contract where they are unable to perform their contractual obligations because of an unforeseen and disruptive event that is beyond the control of one or both parties for the period of the event, includes, for example, COVID–19, war, ‘acts of God’ such as fires, earthquakes and cyclones.

Unlike frustration, which discharges the contract from the time of the frustrating event, a *force majeure*clause suspends the operation of the contract until cessation of the unforeseen event. The *force majeure* clause is interpreted objectively based on what a reasonable person would have understood at the time the contract was made. It can provide the parties to the contract with an option to **suspend**the operation of the contract for the period of the event or terminate the contract if the event looks as though it is going to be drawn out.

A *force majeure* generally requires three conditions to be met if it is to be effective:

- it could have occurred with or without human intervention.
- it could not have been reasonably foreseen by the parties; and
- it could not reasonably have been prevented by the parties because it was completely beyond their control.

A problem with a *force majeure* clause is the need for care in its drafting. The wording must be precise and clear so that the parties understand what events will trigger the provision and then what steps you are required to follow. The clause should set out specific details on

notification (by the affected party), specific details of the event, anticipated length of time, mitigation, obligations of the parties, and suspension or termination of the contract.

Example

An example of a *force majeure* clause

This *force majeure* clause is from a Property Management Framework Agreement by China Southern Airlines Company Limited and China Southern Airlines Group Property Management Company Limited in 2017:

Force Majeure

> *1. In the case of failure to perform this Agreement due to any force majeure, neither party shall be liable for such failure, and this Agreement shall be terminated automatically. In the case of failure to perform any part of this Agreement due to any force majeure, the party suffering from such force majeure may be exempted from corresponding liability to the extent of the impact of such force majeure. However, such party shall continue to perform other obligations under this Agreement which have not been affected by such force majeure. If such force majeure occurs after such party delays to perform this Agreement, it shall not be exempted from its corresponding liabilities.*

Force Majeure may refer to an unforeseeable, unavoidable and unconquered objective situation, including but not limited to war, plague, strike, earthquake, flood, etc.

> *2. Any party failing to perform this Agreement due to any force majeure shall notice the other party within forty-eight (48) hours so as to reduce the possible loss caused to the other party and provide the proof of such force majeure within fifteen (15) working days. If it fails to perform its such obligations within the required time for rational reasons, such required time may be extended according to the actual conditions.'*

Fairness of Transactions Act 1993 in Papua New Guinea

Section 4 of the ***Fairness of Transactions Act 1993*** attempts to ensure that no party is

unfairly advantaged or disadvantaged as the result of entering into a contract (s 4(1)), and to this end, the court has been given wide powers to ensure an equitable adjustment is achieved between the parties.

Reflection questions

Take a break and attempt these 2 problems (that are already decided cases):

1. An English firm agreed to sell and deliver machinery to a Polish company, which paid £1000 (approximately K5000) in advance. The English firm commenced work on the machine, but because of the outbreak of war and the German occupation of Poland, the contract was frustrated. The question of frustration was not in issue; the Polish company claimed the right to recover the deposit it had paid before the frustrating event. The English firm claimed that it had done a considerable amount of work on the machine. What is the effect of frustration in this case?
2. Imagine you wanted to hold a concert and an express term as to the purpose for which the hall you wanted to use was that it was in a fit state for a concert. Unknown to the parties the hall burnt down without their knowledge while they were still negotiating. A contract was subsequently entered into and both parties at the time of entering into a contract believed that the hall still existed. Has the contract been frustrated? Explain why or why not.

Section 3: What remedies are available for breach of contract?

The usual remedy for a breach of contract is an award of **damages**, which is a common law remedy. However, if a monetary remedy is not satisfactory, the court **may**exercise its discretion and order any one of several equitable remedies, including restitution, specific performance, an injunction, *quantum meruit*,or an Anton Piller order. It should be remembered that equitable remedies are based on the concept of fairness and are discretionary.

What are the steps in determining an award of damages?

Five (5) steps **must**be taken to determine whether the injured party will recover damages:

- **Step 1:** the onus is on you if you are the injured party (the plaintiff), to first establish that there has been a breach by the other party, which may be a breach of:
  - condition (sometimes referred to as an 'essential term')
  - warranty (sometimes referred to as a 'non-essential term'); **or**
  - innominate term.
- **Step 2:** having proved breach, the onus is on you as the plaintiff, to now establish **causation,** that is, that the loss or damage that you suffered was caused by the defendant's breach of contract. That is, the loss or damage would not have been suffered 'but for' the defendant's breach, and is established by reference to documents, records, and so on, and as this is a civil case, proved on the balance of probabilities.
- **Step3:remoteness of damage,** that is, losses suffered by you must be a reasonably direct consequence of the breach of contract, and this is a question of fact. Losses that are too far removed from the wrongful act are regarded as not reasonably foreseeable and therefore too remote from the breach to be recoverable.
- **Step 4: amount and type of damages,** that is, the general principle concerning damages is that you as the injured party should be to put you in a position you would have been in had the breach never occurred. You mustbe able to show that they have suffered some loss if you are to recover ordinary damages. If you can't, then at best you may be able to recover nominal damages(a sort of token loss because while there has been a breach of contract, the loss you have suffered is minimal). But you also need to be careful, because while you may have won the case, the judge may be annoyed that you have wasted the court's time and order you to pay the costs of the other side which may be much higher than the token award you received).

The courts will allow claims for damages by a plaintiff (assume you are the injured party) for:

  - expectation damages (losses) arising from your expectation of prospective benefit arising out of or created by the contract – for example, loss of a commercial opportunity and loss of profit occurring from the loss of the defendant's performance.
  - reliance damages (or 'wasted expenditure

Business tip

Saving litigation costs:

damages') arising from expenditure incurred by you relying on the defendant's promise and which is wasted because of the defendant's breach.
    - Other losses
        - injured feelings and anxiety
        - inconvenience
        - frustration
        - discomfort
        - mental distress; **and**
        - disappointment, distress, and hurt feelings.

    Damages may also be recovered by you for breach of an express or implied term that the promisor would provide you, as the innocent party, with pleasure, enjoyment, or personal protection, and the failure to do so has caused physical injury or inconvenience to you.

- **Step 5: mitigation** (minimisation) of damages, that is, in addition to the questions of remoteness and measure, the law imposesa duty on you as you are the person claiming damages (the injured party) to take all reasonable steps to reduce or minimise (mitigate) your loss. If you fail to take this step, for example, where an employer dismisses you as an employee for no reason, the amount of damages you can expect to recover will be reduced by an amount representing the value of any failure to take reasonable steps to find new employment. The burden of proof is on the defendant to show that you failed to mitigate your losses, and this is a question of fact.
    - Whether there is a need to mitigate is a question of law. Thus, if a person such as yourself is wrongfully dismissed from your job, you must take reasonable steps to find other employment.

> The plaintiff can only recover damages reasonably foreseeable as likely to result from a breach. This depends on the knowledge possessed by the parties and may be actual or constructive. Actual knowledgemeans that the defendant knew what the situation was. Constructive knowledgemeans that a reasonable person would have known what the situation was.
>
> Tell the defendant of any special or exceptional circumstances that may apply at the time of making the contract. A defendant can then make an informed choice as to whether to accept the risk that might arise if there was a breach.

Business tip

Minimise the loss:

Whether it be anticipatory or actual breach, as the injured party, you should take immediate steps to minimise the loss or face the prospect of having the court reduce the amount of damages that you can recover.

What types of damages are available to you if you are an injured plaintiff?

Once it has been established that you are as the plaintiff entitled to compensation, it will have to be determined what type of damages you will be awarded. This means looking at two issues:

- the seriousness of the breach; **and**
- whether the contract has specified the amount of damages to be paid in the event of a breach.

Nominal damages are awarded where the court feels that your legal rights have been infringed, but you have suffered no actual loss. The court may therefore decide to award you a token amount.

Ordinary damages (as they are typically called) are the usual remedy in contract law. This is the amount awarded by the court on its assessment of the loss suffered by you as a result of the breach. They are a means of compensation for you and can take two forms:

- **general damages:** in contract they follow as a general consequence from the breach and include the difference between contract and market prices for the goods or services or the value of goods delivered and services carried out and as warranted.
- **special damages:** are asked for in addition to general damages. If they are to be claimed, they must be specially proved in court – for example, loss of profits that result from the failure of the seller to deliver goods to a buyer.

Exemplary damages are generally *not*awarded in contract (although they may be awarded

in tort) unless the court feels that it should punish the party in default, for example, where the breach of contract has resulted in inconvenience, disappointment, or discomfort to you (the innocent party), such as cases involving holiday packages where, for example, the facilities or accommodation have been misrepresented by the travel agent or the person they represent. Here, the courts have been prepared to award what are termed 'aggravated damages for non-pecuniary losses'.

What is the difference between liquidated damages, unliquidated damages andpenalty?

In brief

Liquidated and unliquidated damages and penalty

TYPE	DESCRIPTION
Liquidated	Fixed amount. Must be a genuine or reasonable pre-estimate of actual loss flowing from the breach or, the court may treat it as a penalty and then there will be no remedy.
Unliquidated	Left to the court to determine. Not fixed in the contract as the loss cannot be accurately determined.
Penalty	A clause, intended to deter, penalise or threaten a party, which is out of proportion with the loss that could be suffered from a breach.

Reflection questions

Time for a break and, a good time for you to check on how you are doing by reflecting on these questions

1. Why do the courts refuse to enforce penalty clauses in contracts?
2. Explain the difference between liquidated and unliquidated damages and a penalty.
3. Explain why an injured party to a contract should have to mitigate their loss.
4. Joad Tyres sold car covers and other motor accessories to Casey under a contract which provided that Casey would not sell any of the items below certain listed prices. In the event of breach of the agreement, Casey agreed to pay K50 in liquidated damages for every item it sold below the listed price. Casey subsequently sold a tyre below the listed price and was sued by Joad Tyres. Would you classify the sum as a penalty or liquidated damages? Explain why.
5. You arranged a 2-week holiday in Switzerland through a brochure from Swans Tours. The brochure claimed the accommodation was close to the ski fields, its owner spoke English, and there would be a welcome party on arrival and a farewell party on departure at the bar. However, few of the statements proved to be correct and the trip turned into a disaster. What would you do?
6. The defendant leased a racehorse to you for 3 years. After 6 months, the defendant took the horse back. As part of the damages claim for breach of contract, you sued for loss of potential prize money and profits that you would have made from betting on the horse. Do you think you would succeed in your claim? Why?

Equitable remedies

In addition to the common law remedies mentioned above, there are a number of equitable remedies available to address breach of contract. These are remedies awarded at the court's discretion (called **discretionary remedies**) and include:

- **Rescission:** it is a remedy that the court grants if it orders that the transaction be set aside. The court has a discretion whether to grant it or not. It may be sought on grounds including undue influence, unconscientious bargains, innocent misrepresentation, and mistake.
- **Specific performance:** an order directing a person to carry out their obligations under the contract and is only ordered when damages are not an adequate remedy, and it is just and equitable to do so under the circumstances. It is not usually awarded in contracts that require personal services for another party because of problems with supervision.
- **Rectification:** a court order altering or amending a written contract where the parties have used words that do not express their intention.
- **Injunction:** a court order restraining a party from breaking their contract or from

committing a wrongful act. It will not be awarded if damages are an adequate remedy. Interestingly, an injunction is often used to enforce contracts of personal services by enforcing a negative promise – for example, employment contracts that contain a restraint of trade clause in them.

- **Anton Piller order:** an order that is available only where it can be shown that the defendant has incriminating evidence that is necessary to the plaintiff's case and which may be destroyed before 'discovery' can be made.
- ***Quantum meruit*** ('as much as the person has earned'): an equitable claim for restitution for the unjust enrichment of the defendant and means, and often used by contractors. Essentially, it is an action for payment of the reasonable value of services performed.

The contract may be discharged by breach, but where the contract is for goods or services there is a new implied contractimposed by law on the party taking the benefit that they will pay a reasonable amount for the quantum or portion given. It is not available to the party in breach.

When an innocent party chooses to sue on the *quantum meruit*, and the claim is assessed only based on work done, the party is obliged to:

- prove the value of the work
- show that the work was completed with proper skill; **and**
- show that it was completed within a reasonable time.

The amount recovered depends on whether the contract price is divided between stages or on completion. If you as the plaintiff only partially fulfill your obligations under the contract and payment is made based on the completion of each stage, then there will not be a total failure of consideration and *quantum meruit* is usually only available to recover payment for what you have done. For the incomplete stages, there will be a total failure of consideration.

What is the importance of the Statute of Limitations?

As an injured party, you must remember you only have a certain period of time to bring your action. To prevent the possibility of civil actions remaining open indefinitely, the *Frauds and Limitation Act 1988* determines the time limit within which you *must* commence your action for breach of contract. You have 6 years commencing on the date which the cause of action arose (s 16(1)).

Reflection questions

Take a look at these questions to assess your progress. Plus, the good news is that you are almost finished the Contracts section.

1. Explain under what circumstances a *quantum meruit* claim would arise.
2. Henrietta engaged a firm of solicitors to obtain an injunction to prevent a former friend from visiting her and making a nuisance of himself. An unqualified litigation clerk was given the matter to handle, but his incompetence created further embarrassment for Henrietta. Does Henrietta have any claim against the firm for 'mental distress and upset'?
3. Josef, a well-known film actor, entered into a contract with Frère Bros for a period of 5 years, where he agreed to give his services exclusively to them and not act in films for any other company during this period. During the first year of the agreement, Josef entered into a contract to star in a film being made by Pretty Pictures. Do Frère Bros have any remedy? Explain why.

Section 4: Is there a place for ethics in contract law?

Before we leave contract law, it is worth reflecting on those aspects which contain an ethical element. We can see that the common law of contract provides strict rules relating to the creation and construction of contracts but, at the same time, there are areas of contract law that allow remedies to people where a strict interpretation of those legal rules would be unfair.

We saw that, in a limited way, contract law allows people who may not truly understand the terms and nature of the contract they have entered into, to be released from that contract. So, people under the age of 18 have rights to avoid their legal obligations in certain circumstances. And people who have been affected by drugs or alcohol or have an intellectual impairment, and where the other party sought to take advantage of their situation, also have rights to avoid their legal obligations.

We can see too that contract law will consider the circumstances in which a contract has been entered into to see if there was equality between the parties and that there was

a fair bargain created by a contract. The law recognises where one weaker party may have been threatened with actual or possible physical or verbal violence, or where the relationship between the parties may have been such that one has a powerful influence over the other. Contracts created under these circumstances may be cancelled. Then there can be the extreme situation where the behaviour of one party is so bad that the law allows the more vulnerable party to be excused from an unreasonable contract. In many jurisdictions, including Papua New Guinea, there is legislation which will consider the essential fairness of a contract.

The equitable remedies of specific performance and rectification are further examples where the law will try to 'right' what might be an injustice where a party to a contract is not standing by his or her side of the bargain.

All of these factors are areas where we would say that there is an overlap between law and ethics; where the law is looking beyond what appears to be legal from documents or on a strict application of the common law, to see what the right and ethical outcome should be.

So, when considering legal problems in this subject, as well as identifying and applying relevant legal principles, we should also examine these to question their underlying fairness and whether their application will provide an ethical outcome.

Key points

An understanding of the following points will help you revise material in this chapter.

- **What is the doctrine of privity of contract?** Under the doctrine of privity, only a party to the contract gains rights and incurs liabilities under it. Obligations cannot be transferred to a third party unless all of the parties agree (novation).
- **What circumstances permit rights and obligations under a contract to be transferred?** At common law, assignment of rights is not possible. However, assignment of rights is possible under equity where the intention of the parties is clear, by statute and by operation of law.
- **What are the methods by which a contract is ended?**
    - **By termination.**A self-help remedy used by an innocent party if there has been a repudiation of the contract by the other party.
    - **By performance**.Where the promises made by the parties under an agreement have been properly performed by the parties – that is, completely and precisely performed – the contract is said to be discharged by performance. Note that there

are exceptions to the rule of precise performance – for example, where the contract is divisible, where there has been acceptance of partial performance, where performance is prevented by the other party, and where there has been substantial performance.

- **By agreement.**The original agreement can be cancelled by mutual discharge, release (or abandonment), waiver, substituted agreement, accord and satisfaction, or failure of a condition precedent or condition subsequent.
- **By frustration.** Performance of the contract may become impossible because of the occurrence of something over which the parties have no control.
- **By operation of law.** A contract may be terminated by operation of law, including bankruptcy, material alteration, merger, death of either party (if it is a contract for personal services), or within the time specified by relevant state and territory statutes of limitation legislation.
- **By lapse of time at common law.** A contract doesn't remain open indefinitely but will remain open for a reasonable time.
- **By virtue of a term in the contract.** These terms may have the effect of either preventing the contract from coming into force (condition precedent) or bringing the contract to an end on the occurrence of a certain event (condition subsequent).
- **By breach.** Where a party fails to perform their obligations as agreed, they are in breach. This may be actual breach, where there has been a failure to perform at the time required by the contract, or anticipatory breach, where there is a threatened failure to perform at the time required by the contract.

- **What is the doctrine of frustration, and what are its effects on a contract?**Performance of the contract may become impossible because of the occurrence of something over which the parties have no control. As a result, the parties are discharged from further performance as regards future liability.
- **What is *force majeure*and why might it be a better option for a party than frustration?** A *force majeure* clause relieves a party from performing their contractual obligations where they are unable to do so because of an unforeseen and disruptive event beyond the control of either party. Unlike frustration, which discharges the contract from the time of the frustrating event, a *force majeure*clause suspends the operation of the contract until cessation of the unforeseen event, leaving the parties to terminate if they should so desire.
- **What are the remedies for breach of contract?**The main remedies for breach of contract include the common law remedies of rescission, restitution and damages, and, in equity, specific performance, injunction (including a Mareva injunction), an Anton Piller order and *quantum meruit*.
- **What remedies are available to an injured party at common law?**The normal remedy at common law is damages. However, two other more limited remedies are

rescission, where the injured party can set aside the contract for breach of condition, and restitution, which is based on the concept of unjust enrichment. These remedies are also available in equity.

- **On what principles are damages decided?** For an innocent party to recover damages it must be established by them that there has been a breach of contract that has resulted in them suffering an amount of losses reasonably related to the contract, and that they have taken immediate steps to try to minimise the loss.
- **What are the types of damages?** Damages may be classified as nominal (where no actual loss is suffered by the plaintiff), ordinary or 'real' (where the innocent party has suffered an assessable loss – and which may take the form of general damages, following as a general consequence from the breach or special damages that have been specially proven in court), or exemplary (where the court feels that it is necessary to punish the party in default, although these are very rare).
- **In which situations may an equitable remedy be used?** An equitable remedy, which is discretionary, may be used where monetary compensation is not an adequate remedy for the innocent party. Contracts of personal service aside, the innocent party may wish to compel performance of the contract because the subject matter is unique (specific performance), or they may wish to restrain a party from breaking their contract (an injunction). If the innocent party believes that the defendant is going to remove or dispose of assets in the jurisdiction before the court can decide, they may seek a Mareva injunction to prevent that from happening. Similarly, if the innocent party believes that the defendant has incriminating evidence in their possession that supports their case and they believe that the defendant will destroy it, they may seek an Anton Piller order. Where there has been part performance of a contract involving goods or services, the party not in breach may be able to recover a reasonable amount from the party receiving the benefit (*quantum meruit*).

Summary

Congratulations, you have made it through the large volume of material that makes up contract law. You have progressed from learning how to make a contract, how to check that it is valid, what it is that you and the other party to a contract have agreed upon, and now assessed what happens at the end of a contract: You then finished with

looking at the remedies available to the innocent party for breach and we concluded with a brief overview of some of the ethical considerations involved in contract law.

What's next?

In the next, and last 2 chapters, we will look at something related to contract law, contracts for the sale of consumer goods and services, and agency. A basic understanding of both topics is very useful for you, not only when you go into business but in your personal lives as well.

PART IV

PART 4. CONSUMER LAW

13.

CONSUMER PROTECTION

Learning objectives

By the end of this Chapter, you should be able to:

- Outline the main factors which have contributed to the rise in consumer protection legislation in PNG.F
- Explain and apply the term ‘misleading and deceptive conduct’.
- Explain and apply the term ‘false representation’ in relation to the supply or possible supply of goods and services.
- Discuss the relationship between consumer protection laws and unconscionable conduct.
- Explain the concept of implied guarantees in consumer contracts.
- Describe and apply the possible remedies and defences that may be available under consumer law.

Key terms

You will notice these key terms, which are mentioned throughout the chapter, to help you to better understand and remember the material:

- **Agreement to sell:** where the property in the goods is to be transferred at some later date, or when some condition has to be fulfilled, such as payment of the price.
- **Ascertained goods:** goods which, in a contract for the sale of unascertained goods, have become identified and agreed on by the parties.
- ***Caveat emptor:*** is Latin for ‘let the buyer beware’ and means that the buyer is buying the goods at their own risk.
- **Chattels:** any property other than freehold land; articles of personal property.
- **Chose in action:** a personal property right to an intangible object such as a debt.

- **Contract for the sale of goods:** under the *Goods Act 1951*, a contract whereby the seller transfers, or agrees to transfer, the property in goods.
- **Existing goods:** goods owned or possessed by the seller at the time of the contract.
- **Future goods:** goods to be manufactured or acquired by the seller after the making of the contract for sale.
- **Goods:** broadly defined, all 'chattels personal other than things in action and money'. This generally includes only physical and movable things, ownership of which transfers to the buyer for a money consideration, called the price.
- **Market overt:** an open, public, and legally constituted market regulated by the rules framed by a local government.
- **Mercantile agent:** also known as a 'factor' is a person who has authority to buy and sell goods, or consign them, on behalf of his principal.
- **Personal property:** any property that is not land, buildings or fixtures to land such as cars, boats, furniture.
- **Possession of goods:** the control or custody of goods.
- **Property in goods:** ownership of, or title to, goods.
- **Romalpa clause:** a retention of title clause that is often used in contracts for the sale of goods that title remains with the seller until the buyer meets a predetermined condition such as payment of the purchase price.
- **Sale of goods:** the transfer of ownership (or property) from the seller to the buyer at the time of the contract.
- **Specific goods:** goods identified and agreed on at the time of the contract of sale.
- **Unascertained goods:** goods that are defined by description only. They are not identified when the contract is made, and they may or may not be future goods.

Introduction

At last, you have nearly reached the end. Consumer Law, which is the second last chapter of this unit, has a connection with Contract Law and is an important topic in business and commerce, as well as to you as a consumer. Consumer protection laws in PNG at the time of writing are under review. Current consumer legislation is focused on the *Goods Act 1951*, the *Independent Consumer and Competition Commission Act 2002*, the latter having a focus on industry regulation but it does provide some protection to consumers with regard to the price, quality, and reliability of goods and services, the *Fairness of Transactions Act 1993*, the *Packaging Act 1974* and the *Commercial Advertisement (Protection of the Public) Act 1976*. The future may see the introduction of specific aspects of Australian Consumer

Law and we shall make brief reference to specific aspects of the Australian Consumer Law at the end of this chapter to provide a sense of what may be the future of consumer protection.

Consumer protection

This chapter deals with particular types of contracts – contracts for the sale and supply of goods and services. As we noted in previous Chapters, the common law has always recognised inequalities that can occur in contractual relationships because of factors such as misrepresentations, unequal bargaining power, and unconscionable conduct. However, the remedies available to the innocent party were often limited (for example, rescission, damages) and were applied by the courts with caution, so as not to threaten the general principle of freedom to contract.

This principle was epitomised in the Latin phrase *caveat emptor* ('let the buyer beware'), which may have been adequate in its time, but the situation is different today, with advances in transport and technology providing suppliers of goods and services with almost unlimited markets. Supermarkets carry thousands of mass-produced items, many of which are packaged in sealed containers with little or no chance of pre-purchase inspection by the buyer. Advertising is increasingly used as a means of informing (or in some cases misleading) potential customers about the attributes of the goods or services that they are urged to buy.

Over time, consumers and governments have become more concerned with the imbalances between the bargaining power of suppliers and consumers. During the last 50 years, countries around the world have been introducing legislation aimed at prescribing minimum quality standards and increasing protection for consumers like us.

It is worth noting that the PNG Government commissioned a Consumer and Competition Review (completed in 2017) which appears to be based on the Australian Consumer Law, so we will spend a short time looking at specific aspects of that as at some point in the future it may form the basis of new PNG consumer laws as the current *Independent Consumer and Competition Commission Act 2002*needs updating when you compare it with what the Australian federal government has done with the introduction of the Australian Consumer Law. And, to ensure that businesses comply with the legislation, the fines for a breach of the *Competition and Consumer Act 2010 (Cth)*, which includes the Australian Consumer Law as Schedule 2, were increased in 2022 from A$10 million to **A$50 million per breach for a body corporate**, and for**individuals it is A$2.5 million** (now take a deep breath and work out what that is in PNG Kina when A$1 = K2.59 at the time of writing).

What are the current consumer protection laws in PNG?

Like most countries, PNG has recognised that consumers need protection in entering into certain types of contracts and has enacted legislation to provide an easier basis to bring actions, rather than having to rely on common law principles, and the *Goods Act 1951* as an early form of consumer protection.

The current consumer protection laws in PNG include:

- the *Goods Act 1951*, but note it's application is limited to goods, *not* services
- the *Independent Consumer and Competition Commission Act, 2002* , administered by the Independent Consumer and Competition Commission (note that the *Independent Consumer and Competition Commission Act 2002* only provides limited protection to consumers, mainly in relation to consumer product safety)
- the *Packaging Act 1974*
- *Commercial Advertisement (Protection of the Public) Act 1976,* **and**
- the *Fairness of Transactions Act 1993* which offers some protection to a consumer with its emphasis on the overall fairness of any transaction so that '*no person suffers unduly because he is economically weaker than, or is otherwise disadvantaged in relation to, another person*.' But it is also limited in what it can do to protect the consumer.

Part 1: *The Goods Act 1951*

We will review the *Goods Act 1951* but it will not be in great deal. Hopefully, it will give you an overview of what it does and the protection it offers you as a consumer.

The underlying principle of the *Goods Act 1951* is that contracts for the sale of goods have certain terms in common that do not need to be expressly stated every time a contract for sale is entered into to protect the consumer. Implied terms are terms that are not expressly stated in a contract but which the law implies are included in the contract – for example, when we are buying something, we presume that the seller owns the goods and has a right to sell them, that they are of merchantable quality (that is, they are saleable) and fit for purpose.

We will begin considering the formation of the contract, what terms are implied by the *Goods Act 1951*, the distinction between propertyand possession, the different classifications of goods, the rules to determine when property passes, the effect of transfer of title by a non-owner, the duties of the seller and the buyer, and the remedies for breach. We will then look at the duties of the buyer and the seller to complete a contract for the sale of goods, and the remedies that are available to the parties if there is a breach.

The *Goods Act 1951* is an example of the application of all the principles that we looked at in the previous chapters on the creation and validity of a contract.

What are the requirements for the formation of the contract?

For the *Goods Act 1951* to apply to a transaction, there are some things you need to know first. These include:

- what exactly are we buying – goods and/or services? *Note it only applies to goods*.
- what is the price? **and**
- are we buying ownership or property in the goods?

A contract for the sale of goods (*not services*) is defined in the *Goods Act 1951* as 'a contract whereby the seller transfers, or agrees to transfer, the property in goods to the buyer for a money consideration called the price' (s 3(1)). This means that there **must**be:

- goods
- money consideration (called the price); and
- transfer of property.

A contract of sale may be in writing (a good idea for certainty if the goods have a monetary or other value to you), oral, partly in writing and partly oral, or implied from the conduct of the parties (s 5).

In brief

What is the difference between the words 'property' and 'possession'?

There is a fundamental difference between 'property' (legal title or ownership) in goods and 'possession' (physical control) of goods that both consumers and businesses must be aware of, because:

- risk in goods passes with property; **and**
- for the *Goods Act 1951* to operate, property or ownership of the goods must pass to the buyer.

A seller who doesn't have title cannot pass anything on to a buyer.

What are 'goods'?

Goods are broadly defined to include all chattels personal other than things (or choses) in action such as a personal property right such as a car, boat or furniture, and money (s 1(1)). This generally includes only physical and movable things. It doesn't include:

- **land or things attached to land** (although it does include timber and growing crops that are to be harvested before sale or under the contract of sale)
- **choses in action or rights**, for example, debts, negotiable instruments, shares or

patents that can be sold but that are not goods ('choses in action'); or
- **services**, such as work and labour, or repairs.

What is the price paid for the goods?

The price paid for the goods is the money consideration. If no money is present, there can be no sale of goods contract; there is either a barter or exchange.

What is the importance of transfer of ownership?

There must be transfer of ownership (what in law is called 'property' or 'title') in the goods if the transaction is to be caught by the *Goods Act 1951*. The importance of transfer of ownership is that risk of loss of the goods goes with the person who has the ownership in the goods. If you go and buy something; you get ownership (the property in the goods) and possession…and the risk of loss or damage to the goods becomes your responsibility.

Is the contract a contract for sale of goods or for work and materials?

Once it has been determined that a transaction falls under the *Goods Act 1951*, it is necessary to be able to decide whether a contract is for the sale of goods (where the *Goods Act 1951* will apply) or for work and materials or repair (where *Goods Act 1951* will **not** apply and the buyer will have to rely on contract law).

Here problems can arise because a large number of contracts involve both an element of service and an element of goods – for example, the supply and fitting of an oil heater, washing machine or air-conditioner, or the service on a car. What is the main purpose of the agreement? Is it to transfer ownership of goods? If it is, it is a contract for the sale of goods.

Business tip

Once it is clear that the *Goods Act 1951* applies, look to the main part of the contract and consider whether it is for the transfer

If the main part of the agreement is the skill and experienceto be displayed by one of the parties in performance of the contract, and the transfer of title to the materials is of secondaryimportance, it is a contract for work and labour and the supply of materials, and *Goods Act 1951* will **not**apply.

What is the difference between a sale and an agreement to sell?

The definition of a 'contract for the sale of goods' includes two types of contracts:

- a sale of goods, where ownership (or property) transfers from the seller to the buyer at the time of the contract, and hence is an executed contract; and
- an agreement to sell, where the property in the goods is to be transferred at some later date, or when some condition has been fulfilled, such as payment of the price, which is known as an executory contract. Once the time elapses or the conditions are fulfilled, the agreement to sell will become a sale.

Are there any formalities to be observed in making a contract of sale?

There are no special formalities to be observed. The normal rules of contract law apply and the contract may be in any form—oral, written, partly oral and partly in writing, or implied from conduct (s 5(1)). Just note though that if the goods are of any value to you, and this can either be in price or sentimental value, put the contract in writing because if something goes wrong with the contract, you have written evidence to support your claim.

A contract for the sale of goods to the value of K20 or upwards is unenforceable unless you, as the buyer:

- accepts part or all of the goods and has received them; **or**
- has paid a deposit or given something in part payment of the price – for example, the trade-in of a car on another car; **or**
- there is a written note or memorandum of the contract signed by the party to be charged or their agent showing:
  - the names of the parties
  - the identity of the subject matter
  - the price and terms of payment if they have been agreed on, **and**
  - the signature of the party to be charged or their authorised agent.

The note or memorandum need not be contained in one document but may be contained in a series of documents, provided that they can be read together to satisfy *Goods Act 1951*. Furthermore, they may be obtained after the sale has taken place.

of title of goods, or skill and experience.

When does property pass?

Property transfers in a sale at the time of sale, while with an agreement to sell it transfers at a later time, thus affecting the rights of the parties and who bears the risk if the goods are damaged.

Reflection question

Take a break for a couple of minutes and test your understanding of what you have just read.

PROBLEM:

The plaintiff verbally agreed to paint the defendant's portrait for K1500. In a dispute over payment, the defendant argued that it was a contract for the sale of goods and was unenforceable because it had not complied with a statutory procedural requirement. Did the painting of the portrait involve the supply of goods or skill and labour?

Just as a matter of interest, if you think the contract is not a contract for the sale of goods, does that mean it is not a contract at all and therefore no rights are created? And what would you say if one of the parties died? Explain why.

What are the terms of the contract?

The implied terms found in the *Goods Act 1951* are framed as conditions or warranties and, as noted above, where business-to-business contracts are concerned, they may be excluded by the parties to the contract. However, this is subject to the usual rules of common law relating to exclusion clauses and s 4 of the *Fairness of Transaction Act 1993*. Remember when we looked at exclusion clauses in Chapter 11, if the document was unsigned, would a reasonable person have regarded the document as one that would contain contractual terms? And even if sufficient notice has been given of the term, did it cover the breach?

Is the term a condition or warranty?

Where it is possible to discover, by inspection, the quality and condition of the goods and their fitness for a particular purpose, at common law the buyer may lose any legal rights that may have existed against the seller if the goods are not satisfactory providing each party is negotiating on equal terms and so the maxim '*caveat emptor*' (let the buyer beware) prevails. Buyers have only themselves to blame if they fail to make a careful inspection

of the goods before they purchase them. The reason we say ‘may’ is because s 4 of the *Fairness of Transactions Act 1993* may apply.

Under the *Goods Act 1951*, it should be noted that where a contract of sale is subject to a condition to be fulfilled by the seller, the buyer can waive the condition, or treat the condition as a breach of warranty which will then mean the contract cannot be repudiated (s 12(1)). If a contract is not severable and the buyer has the goods or part of the goods, or the contract is for specific goodsand the property has passed to the buyer, the breach of a condition can only be treated as a breach of warranty and the goods cannot be rejected (s 12(4)).

However, while the idea of caveat emptor is to encourage buyers to take care, there are circumstances in which the application of the common law rule would prove unjust. Two examples would be:

- when there is no reasonable opportunity for inspection (for example, goods packaged in containers, tins, or wrapping); **and**
- when the buyer must rely on the special knowledge or expert judgment of the seller.

As a result, where the buyer is at a disadvantage, the*Goods Act 1951* implies several terms into contracts as either conditions or warranties.

Whether or not a term in a contract is a condition or a warranty depends in each case on the construction of the contract.A term may be a condition, even though it is referred to as a warranty and vice versa in the contract by the parties.

What are the terms implied in the *Goods Act 1951*?

In a contract for the sale of goods, unless a different intention appears from the terms of the contract, for example, a clause excluding the operation of the *Goods Act 1951* under s 12, the following terms, which are exceptions to the *caveat emptor* rule (let the buyer beware), are implied into consumer and non-consumer contracts for the sale of goods.

> From this point on, we are assuming that **‘you’** means the buyer.

What does the term ‘title’ mean? (s 13)

There is an implied condition in both the case of a sale and an agreement to sell that the seller has a right to sell the goods. But note that there is only an implied warranty if you are

the buyer that you will have and enjoy quiet possession of the goods, and that the goods are free from any charge or encumbrance in favour of any third party not declared or made known to you before or at the time when the contract was made.

What is a sale by description? (s 14)

There is an implied condition that goods sold by description will correspond with that description, and, if the sale is by sample and description, the bulk of the goods must correspond with **both** requirements.

What does fitness for purpose (s 15(2(a)) and of merchantable quality (s 15(2)(b)) mean?

There is **no** implied condition or warranty as to the quality or fitness for a particular purpose *unless you* make known to the seller:

- the particular purpose for which the goods are required and can show that you relied on the seller's skill or judgment, and they are goods that the seller normally sells. Then there is an implied condition that the goods are reasonably fit for that purpose (s 15(2)(a)), **and**
- where the goods are bought by description from a seller who deals in goods of that description (whether or not he is the manufacturer), there is an implied condition that they will be of merchantable quality (s 15(2)(b)).

Two further points to note. First, if the goods are bought under a patent or trade name, there is no implied condition (s 15(3)). Second, if the buyer has examined the goods, again there is no implied condition if there were defects that the examination should have revealed (s 15(4)).

What is a sale by sample? (s 16)

In the case of a contract of sale by sample, where there is an express or implied term in the contract, *Goods Act 1951* implies three conditions:

- that the bulk will correspond with the sample in quality
- that the buyer will have a reasonable opportunity to compare the bulk with the sample, **and**
- that the goods will be free from any defect, rendering them unmerchantable, which would not be apparent on any reasonable examination and would cause the goods not to be of acceptable quality.

Can you exclude the implied conditions and warranties? (s 55)

The implied conditions and warranties may be excluded by the parties under the *Goods Act 1951* by express agreement, or while dealing with the parties, or usage if the usage binds both parties.

Why is the distinction between property and possession important in business?

Many people assume that if a person has possession of goods,that person must also be the owner. But this is a presumption and is based on appearance and one that can lead to serious problems for an unwary buyer such as yourself.

There is a vast difference between the meaning of the terms ‘property in’ and ‘possession of’ goods:

- ‘*Property in goods*’ means the same thing as ‘ownership’ or ‘title’ and is a **legal relationship**. It means you have the legal right to control and use the goods however you want. But remember that getting ‘property’ in the goods also means that riskpasses to you when the contract is made. If you have the property in the goods and they get damaged or destroyed, that’s your problem.
- ‘*Possession of goods*’ refers to the**physical control or custody**of the goods. While possession can create a strong presumption of ownership as it gives you immediate physical control or occupancy, it does not transfer ownership rights and there is a duty on you to take reasonable care of the goods or property while they are in your possession.

For example, if you leave your car to be serviced at a garage, ownership or title of the car remains with you. The garage has possession. A change in possession has occurred without a change in ownership. But equally, a change in ownership may occur without a change in possession – for example, where you sell your car to a leasing company and then lease it back from them.

Business tip

'Property' and 'possession' do **not** mean the same thing: 'property' means ownership, while 'possession' means control.

When does property pass? (ss 17, 20)

Under the *Goods Act 1951*, provision is made for determining when property in goods is transferred to the buyer in the absence of intention by the parties. Unless the buyer has agreed to bear the risk, the general rule is that any damage or loss suffered to the goods before property passes to you as the buyer is borne by the seller (s 20).

There are no problems where the goods are sold over the counter, but when delivery is to take place at a later date, and the goods are damaged before delivery, it would often be difficult, in the absence of rules, to determine who should bear the loss. Even when the property has passed to you as the buyer, but possession remains with the seller, it doesn't necessarily follow that the seller must automatically deliver the goods to you unless credit has been agreed between you and the seller. The seller is entitled to payment before delivery. However, the fact that you have property in the goods usually means that you also bear the risk, but the seller may still be liable for lost or damaged goods as a result of negligence if they are acting as a bailee because they are bound to take reasonable care.

Business tip

When does risk pass?

Unless the buyer has agreed to bear the risk, the general rule is that any damage or loss suffered to the goods before property passes to the buyer is borne by the seller. If problems arise, it is usually when delivery is to take place at a later date, and the goods are damaged before delivery – who has the risk? An appropriate clause should be inserted in the contract between the parties stating who is to bear the risk, and appropriate insurance arranged by the party at risk.

What does classification of goods mean?

Goods that are the subject of a contract of sale can be divided into several classifications under the *Goods Act 1951*:

- existing
- future
- specific
- unascertained; **or**
- Ascertained.

Although, it will be apparent that there is an overlap. The distinction is important for determining when the property, and hence risk, in the goods passes to you as the buyer.

What are existing goods? (s 7(1)(a))

These are goods owned or possessed by the seller at the time of the contract – for example, a dealer who has for sale and in stock a 2024 white Toyota Prado.

What are future goods? (s 7(1)(b))

These are goods 'to be manufactured or acquired by the seller after the making of the contract for sale' – for example, the purchase of a new Toyota Prado that is yet to be manufactured by Toyota.

What are specific goods? (s 1)

These are goods identified and agreed on at the time of the contract of sale – for example, a 2022 white Toyota Prado.

What are unascertained goods? (s 17)

These are goods that are defined by description only. They are not identified when the contract is made and they may or may not be future goods. Until the goods are ascertained, it is merely an agreement to sell – for example, a sale by a dealer of a new Toyota Prado that is yet to be made – until that particular car comes off the assembly line and is earmarked for you, the car is a future and unascertained good.

How do ascertained goods differ from unascertained goods? (s 18)

These are goods that, in a contract for the sale of unascertained goods, have become identified and agreed on by the parties. For example, if you order a new white BMW 520i car and the dealer has a number of that make, model and colour in stock, the goods are

unascertained until a particular car from that dealer's stock is selected and identified (or ascertained) to your contract.

When does property pass where the goods are ascertained goods?

When does property pass? (s 18)

- the conduct of the parties,
- the circumstances of the case; **and**
- the terms of the contract. If it is unconditional and the goods are in a deliverable state, property passes to you when the contract is made. But if the seller must do something to put the goods in a deliverable state, property doesn't pass to you until the thing is done and you have notice of it. If the goods are delivered to you on approval or 'on sale or return', property passes to you when you signify your approval.

Where property (ownership) has passed, and remember that risk passes with property (s 20), you as the buyer can elect to treat a breach of condition as a breach of warranty and sue for damages, rather than treating the contract as at an end (s 12(4)). If the intention of the parties isn't clear, the following rules need to be looked at to determine the time at which the property in the goods is to pass to you as the buyer. Sections 18(3)(a) to (s 18(3)(d) deal with contracts for the sale of specific or ascertained goods, while s 18(3)(5) applies to a contract for the sale of unascertained or future goods by description.

Unconditional contract for specific goods (s 18(3)(a))

Property passes to you as the buyer if the following requirements have been met:

- there is an unconditional contract
- the contract is for the sale of specific goods, and
- the goods are in a deliverable state.

The time of delivery or payment, or both, is immaterial if property and risk have passed.

Business tip

Take care where property, but not possession, has passed to the buyer

Where there is an unconditional contract for the sale of specific goods in a deliverable state, property and risk pass you as the buyer when the contract is made, and the time of delivery is immaterial. If the goods are not to be picked up immediately, you should take steps to protect against damage to your goods while they are out of your possession – for example, with insurance or a clause to the effect that they remain with the seller at the seller's risk.

Conditional contract for specific goods (s 18(3)(b))

Where the seller must do something to the specific goods to put them into a deliverable state, property in the goods doesn't pass until it is done, and you have notice of it. For example, if you buy a new car but it must be registered by the dealer, the car is not in a deliverable state until registered.

Contract for specific goods that require pricing (s 18(3)(c))

Where there is a contract for the sale of specific goods ready to be delivered, but the seller must weigh, measure, test, or do some other thing to the goods to work out the price, property doesn't pass until this has been done and you have been notified – for example, where wheat is sold at a certain price per kilogram, and the seller first has to weigh it to determine the price.

Contract for goods on approval (s 18(3)(d))

Where goods are delivered 'on approval' or 'on sale or return', property passes to you:

- when you give approval through words or conduct – for example, by using the goods
- when you do any other act adopting the transaction (for example, lending the goods to a third party); **or**
- if you retain the goods for more than the agreed time or beyond a reasonable time. This is a question of fact in each case—for example, if you accept goods under an agreement of sale or return within 14 days and keep them longer than this, they would be considered to have adopted the agreement.

Contract for unascertained or future goods sold by description (s 18(3)(e))

Where there is a contract for the sale of unascertained or future goods by description, and goods of that description in a state ready for delivery are unconditionally appropriated

(selected) to the contract by either party with the assent of the other, the property passes at once to you. Assent can be either express or implied. Once the seller notifies you of an appropriation, unless you object within a reasonable time the property in the goods, and the risk, will be deemed to have passed to you.

Why should a business reserve a right of disposal? (s 19)

Where the seller has delivered the goods to you, or a carrier for the purpose of delivery to you, and the seller doesn't reserve the right of disposal, delivery is an unconditional appropriation of the goods to the contract.

When the seller reserves the right to retake possession of the goods if certain conditions are not fulfilled (for example, as to payment), the property in the goods won't pass until those conditions have been met. In such cases the appropriation is not unconditional.

In an attempt to preserve the property(or ownership) rightsin their goods until they had been paid for, a seller would often include a reservation of title clausein the contract of sale. This created an equitable interest or charge in favour of the original seller. If you fail to pay for the goods, went into receivership, or became insolvent, it could be argued that the seller can repossess the goods because they still have property and title in the goods. Risk passes to the buyer upon delivery. These clauses are also called 'Romalpa clauses'.

What is the purpose of the *Personal Property Securities Act 2011*?

The *Personal Property Securities Act 2011* covers security interests over personal property other than land. A security interest is an interest in personal property that in substance secures payment of a debt or other obligation. In addition to covering standard forms of security such as chattel mortgages, the definition also covers retention of title clauses in contracts under which a purchaser has possession of property but does not acquire title from the vendor until the full purchase price is paid.

Under the *Personal Property Securities Act 2011*, retention of title suppliers become secured parties with a security interest, called a 'purchase money security interest'. This type of security interest gives the secured party a superior status over other secured interests. To take full advantage of the protections offered by the *Personal Property Securities Act 2011*, the secured party must register their security interest on the Personal Property Securities Registry. By registering a security interest, the retention of title supplier takes priority over all others. Registration also means that the property will not be available to a trustee in bankruptcy or to a liquidator.

Business tip

Preserve ownership rights by a reservation of title clause under the *Personal Property Security Act 2011*.

It is in the seller's interest to preserve their ownership rights where you as the buyer have possession but have not paid in full for the goods. If you default, or go into receivership or liquidation, the seller may lose the goods if they haven't used a 'reservation of title' or 'Romalpa' clause to reserve title or legal ownership over the goods and registered their interest in the goods with the Personal Property Securities Registry. If you default, the seller may be able to get the goods back from an innocent third party.

Reflection questions

Before you take a break, take a moment to review the following questions and assess your comprehension of the material we have covered so far:

1. What is the meaning of the following terms, giving an example in each case?
    1. specific goods.
    2. future goods.
    3. unascertained goods.
2. Into which classification would the following goods be placed?
    1. 10 kilograms (kg) of sugar out of a 100 kg bag of sugar.
    2. an LCD flat-screen TV on display in a shop.
    3. a second-hand blue Toyota Camry car.
3. Explain the purpose of a Romalpa clause in a sale of goods contract. What impact, if

any, has the *Personal Property Securities Act 2009* (Cth) had on Romalpa clauses?

PROBLEM:

A carrier was sent by the buyer, Wardar's (Import and Export), to pick up 600 cartons of kidneys that were being held by the seller, Norwood & Sons, in cold storage. The cartons were part of a larger consignment held in the cold store. When the carrier arrived at 8 am, he discovered the cartons had been stacked on the pavement ready to be loaded. The carrier handed over the delivery note and started loading. He didn't turn on his truck's refrigeration unit until 10 am. By 11 am some of the cartons had started to defrost. Loading was completed at noon. By 1 pm the refrigeration became effective. By the time the buyer received the cartons they were unfit for human consumption. He refused to pay for them, arguing that they were not of merchantable quality, and the seller counterclaimed for the price. Does the buyer have to pay for the kidneys?

What happens if the sale is not by the owner? (s 21)

In some cases, the conduct of the owner may be such that the owner is estopped (or prevented) from denying the authority of the seller to sell the goods. The owner of the goods, by their words or conduct, must make a third party believe that another person has the right to sell the goods—for example, a sale by a car dealer of a car, where the car is in fact owned by a finance company or you get no better title then the seller had.

What is market overt? (s 23)

Usually, these are markets controlled by municipal councils. Where goods are purchased in market overt, a buyer acquires a good title provided that the goods are on open display, and are bought during market hours in good faith, and without any knowledge of the lack of title of the seller.

What is a sale under a voidable title? (s 22)

If a seller has a voidable title (that is, a title that is valid and binding until and unless it is repudiated by the true owner) at the time of sale, the buyer acquires a good title:

- provided that the goods were bought in good faith, and
- without notice of the seller's defective title.

The most common situation of this kind is one where the seller has been induced to enter into an agreement by a misrepresentation, made innocently or fraudulently, by you.

What is the position of a buyer or seller in possession after sale? (s 25)

If a seller continues in possession of the goods or holds the documents of title after a sale, and then they (or a mercantile agent acting for them) transfer the goods or the documents of title to a third party, who buys them in good faith and without knowledge of their previous sale, the second sale is considered good.

Where you, with the seller's consent, are in lawful possession of the goods or the documents of title after sale of either the goods themselves or the documents of title to the goods that are still subject to some lien or charge in favour of the seller, you can give a good title to a third person who receives the goods or documents of title in good faith and without notice of the rights of the seller.

What is the position with factor or mercantile agents? (ss 61 – 64)

Where a factor or mercantile agent is entrusted with the possession of goods or documents of title to any goods from a principal for consignment or sale, they will be regarded as the true owner for the purpose of any sale, pledge, lien or other disposition of the goods they make in the ordinary course of their business, provided that the consignees:

- act in good faith; **and**
- are unaware of the limitation placed on the agent.

What are the rights and duties of the parties in performance of the contract? (ss 27, 29(1))

To complete a contract for the sale of goods (s 27):

- the seller must be ready to deliver or give possession of the goods; and
- you, as the buyer, must be ready to accept and pay for them in accordance with the terms of the contract.

Delivery takes place when there is a voluntary transfer of possession from the seller to you but whether you take possession, or the seller sends the goods to you, depends in each case on the terms agreed to between the parties. This need not be the physical act of handing over; it may be symbolic, as in the delivery of a key to the warehouse where the goods are stored, or in handing over a document of title, such as a bill of lading.

What is the duty of the seller in respect of delivery? (ss 29-37)

The *Goods Act 1951* sets out a number of general rules as to delivery (see ss 29 – 37). These will apply if the contract between the parties doesn't say anything about delivery:

- **Putting the goods into a deliverable state (s 29(7))**

The expense of putting the goods into a deliverable state lies on the seller.

- **Delivery (s 29(2))**

This is usually the seller's place of business. However, in the case of specific goods that the parties know are in another place at the time of contract, that place is the place of delivery.

- **Third parties (s 29(5))**

If the goods at the time of sale are in the hands of a third party, there is no effective delivery until the third party acknowledges to the buyer that the goods are held on the buyer's behalf.

- **Time (s 29(4))**

If no time is fixed for delivery, the seller is bound to send the goods within a reasonable time. What is a reasonable time is a question of fact in each case. Thus, it would be expected that perishable goods would be delivered more quickly than non-perishable goods.

- **Quantity (s 30)**

It is the duty of the seller to deliver the exact quantity of goods ordered by you. However, a trifling difference doesn't give you the right to reject the goods, although this is subject to trade usage, special agreement, and the course of dealing between the parties.

- **Instalments (s 31)**

You are not bound to accept delivery of goods by instalments, unless you and the seller have agreed to this. If the agreement is that the instalments are to be paid for separately, and the seller makes defective deliveries, the seriousness of the breach and the likelihood of it being repeated must be considered in the context of the contract as a whole when it comes to termination.

- **Delivery to a carrier (ss 32(2), 33)**

Unless otherwise authorised by the buyer, any contract a seller makes with a carrier for you must be in your interest. If the seller doesn't do this, and the goods are lost or damaged in transit, you may:

- decline to treat the delivery to the carrier as a delivery to you; **or**

- hold the seller liable for damages.

If the carrier is the agent of the seller, effective delivery occurs when the goods have been delivered to you. However, if delivery is to a distant place – for example, another state – the risk of deterioration of the goods is then with you.

Reflection questions

Take a break and quickly review the 2 questions ahead to see how much you can recall.

1. The seller agreed to supply 4950 tonnes of wheat to the buyer. On delivery, the buyer discovered that it had received only 4895 tonnes, a shortfall of 55 tonnes, and so refused to accept delivery. Can the buyer reject the whole delivery? Advise the buyer.
2. Coca-Cola purchased 200,000 yo-yos, to be delivered in instalments. They were to be used in conjunction with an advertising program by Coca-Cola. Of the first 85,000 yo-yos delivered, 65,000 were returned as defective. Coca-Cola wants to terminate the contract. What percentage of yo-yos do you think Coca-Cola should have to accept delivery of?

When must you as the buyer accept and pay for the goods? (s 28)

Once the seller has delivered the goods, your duty as the buyer is to accept and pay for them in accordance with the terms of the contract. If no price is stated, you must pay a reasonable or customary price for the goods. If no arrangement has been made as to subsequent payment, you must be ready and willing to pay for the goods on delivery.

When does acceptance occur? (s 35)

You will be deemed to have accepted the goods when:

- you advise the seller you have accepted the goods, **or**
- you have performed any act that is inconsistent with the ownership of the seller when the goods have been delivered (for example, the re sale of goods by you, or use or consumption of the goods), **or**

- after a reasonable time, you retain the goods without telling the seller that the goods have been rejected—what is considered a 'reasonable time' is a question of fact, but problems can arise where the defect is latent and considerable time passes before it is discovered.

Remedies for breach of contract?

Who is an unpaid seller? (s 38)

An unpaid seller includes any person who is in the position of the seller, such as an agent for the seller, and who:

- has not been paid the full price; **or**
- has been paid with a bill of exchange or cheque as conditional payment, but which cheque or bill of exchange has been dishonoured.

What are the unpaid seller's rights? (ss 39 – 43)

The unpaid seller's rights depend on whether or not the property or possession of the goods, or both, have passed to you as the buyer:

- Where property and possession have passed to you, the unpaid seller has rights only against you personally.
- Where the unpaid seller has possession of the goods or they are still in transit to you, the seller may:
  - exercise a lien on the goods for the price – that is, the right to retain possession until the price is paid
  - in the case of insolvency, exercise the right of stopping the goods in transit, notwithstanding that the goods are no longer in the possession of the seller; **and**
  - have a right of resale.
- Where property in the goods has not passed to you, the unpaid seller has, in addition to the other remedies, the right to withhold or stop delivery of the goods.
- Where the seller has property and possession, the goods may be resold without the seller committing a breach of contract.

What are the seller's remedies?

What is the seller's right to be paid? (s 49)

The seller may sue the buyer for the price of the goods if the property in the goods has passed and you are wrongfully neglecting or refusing to pay for the goods according to the terms of the contract.

The seller may also sue for the price, even if the property has not passed, if the terms of the contract stipulate that the payment is to occur before the passing of the property, and this has not occurred.

Can the seller recover damages for non-acceptance? (s 50)

The seller may sue you for damages arising from non-acceptance where the property has not passed. This is reasonable, since the seller still has the ownership of the goods and may resell them. Of course, if the seller has actually resold the goods, the measure of damages will be the difference between the contract price and the market price at which the goods were sold. The seller is in no position to sue you for the price because delivery is no longer possible.

What are the buyer's remedies?

Your remedies as the buyer against the seller depend on whether the goods have been delivered or not.

Can you recover damages for non-delivery? (s 51)

Where the seller wrongfully neglects or refuses to deliver the goods to you then you may sue the seller for damages for non-delivery. This is the equivalent of the seller's remedy in the previous section.

The general measure of damages will be based on the loss that directly and naturally results from the seller's default, usually being the difference between the contract price and the current market price. Thus, if the market price is the lower, no damages can result. Just note that the onus is on you to minimise your loss.

Can you enforce specific performance? (s 52)

Where the seller fails to deliver the specific goods and they are of a rare kind or quality where damages would not be an adequate remedy, the court has discretion (as this is an equitable remedy) to award a decree of specific performance and direct the contract be specifically performed.

What is breach of warranty of quality? (s 53)

Where there has been a breach of warranty by the seller, or where you have elected (or have been compelled under the sale of goods legislation) to treat a breach of condition as a breach of warranty, you may either:

- set up against the seller the breach of warranty as a ground for the reduction or

extinction of the price asked by the seller; **or**
- bring an action for damages. The damages that you can recover are the difference between the value of the goods at the time of delivery to you and the value they would have had if the seller had complied with the warranty.

To determine the measure of damages, a distinction is maintained between the situation where:

- the seller's breach caused economic loss – in which case the test is whether at the time of contract the seller could reasonably have contemplated the loss as a serious possibility in the event of a breach; **and**
- it caused physical injury to the person or property of you as the buyer – in which case it is whether the loss could be reasonably foreseen at the date of breach as a possible consequence of the breach.

Reflection questions

The last few questions on the *Goods Act 1951* before we have a brief look at some other consumer legislation:

1. Who is an unpaid seller? Briefly explain.
2. Where an unpaid seller exercises a lien over goods, what is the seller doing?
3. Discuss whether the unpaid seller has a right of resale of goods under a contract for the sale of goods. What rights do you have as a buyer under the *Goods Act 1951* if the goods you purchase are faulty?

Part 2: Independent Consumer and Competition Commission

The current consumer protection law in Papua New Guinea is the *Independent Consumer and Competition Commission Act 2002*, administered by the Independent Consumer and Competition Commission. The *Independent Consumer and Competition Commission Act 2002* has provided limited protection to consumers, mainly in relation to consumer product

safety. There are also other Acts which seek to protect consumers' rights in relation to specific industries.


Online reference

Read the About Us page on the Independent Consumer and Competition website for more information about the Independent Consumer and Competition Commission and its role and function in regulated industries and consumer protection.

Also read about the Independent Consumer and Competition Act 2002 on the Papua New Guinea Consolidated Legislation website.

The Consumer and Competition Framework Review (the Review) was initiated by the Department of Treasury in 2014 and its findings were made public in 2017. Of most interest to us is Part II of the Review dealing with consumer protection. Currently the Independent Consumer and Competition Commission's consumer protection provisions are found in Part 7 of the *Independent Consumer and Competition Commission Act 2002* and, only include product safety and information (ss 107 – 121).

For further information on the Independent Consumer and Competition Commission's current role on consumer protection see the Consumer Protection page on the Independent Consumer and Competition website.

In brief, in terms of better consumer protection, the Review recommended several changes to the Independent Consumer and Competition Commission based on the Australian Consumer Law including:

- Codes of Practice for business
- better product safety standards and product information
- prohibit conduct in trade that is misleading or deceptive (the same as Australian Consumer Law s 18)
- prohibit unfair conduct including pyramid schemes (Australian Consumer Law ss 44 – 46), bait advertising (s 35 Australian Consumer Law), coercion or harassment of consumers by traders (Australian Consumer Law s 50), and where recipients receive

unsolicited goods and services (Australian Consumer Law ss 40 – 46), recipients can treat them as gifts; and

- replacing conditions and warranties with consumer guarantees (Australian Consumer Law ss 51 – 63).

Part 3: Other consumer protection legislation

What is the *Commercial Advertisement (Protection of the Public) Act 1976*?

This Act protects the public from any commercial advertisement that may contain untrue, inaccurate, misleading, misrepresentative or unreasonable statements used in describing the size, quality, quantity or nature of goods or services. Enforcement is the responsibility of the Independent Consumer and Competition Commission.

The Packaging Act 1974

Online reference

For your interest, read about the *Packaging Ac 1974* and the *Packaging regulation 1975* on the Papua New Guinea Consolidated Legislation website.

What is the *Packaging Act 1974*?

The *Packaging Act 1974* is responsible for ensuring that goods contain an approved brand by the Minister for Commerce and Trade and are properly labelled, or contain the name and address of the person on whose behalf the article was packed, or the name and address of the packer. The purpose of the legislation is to protect the consumer who buys labelled or packaged goods to ensure that the goods are properly labelled by making it an offence for a person who is not authorised to mark a package that it is an approved brand, or to mark a package with a copy of an approved brand (s 10).

The *Packaging Regulation 1975* specify certain products must have specific packing requirements including medicinal products, plants, dairy products and cooking oils.

Schedule 8 of the Regulations sets out goods exempted from *Packaging Regulation 1975* and is quite interesting to look at the range of products that are exempt.

The *Fairness of Transactions Act 1993*

The purpose of the *Fairness of Transactions Act 1993* is to ensure the overall fairness of any transaction operates fairly and not be manifestly unfair or not be genuinely mutual. Or as s 4(1) of the *Fairness of Transactions Act 1993* puts it:

> *For the purposes of this Act, the concept of fairness relates to the principle of the just and equitable distribution to and among parties to a transaction of the rights, privileges, advantages, benefits and duties, obligations and disadvantages of the transaction in proportion and relative to a party's standing in or contribution to the transaction, and according to business principles and practices appertaining to the particular transaction in question and the provisions of this Act shall be read liberally and applied accordingly.*

'Transaction' is broadly defined in s 3 and 'means any contract, promise, agreement, dealing or undertaking of an economic or commercial nature whether supported by consideration or not entered into between parties,' and includes both informal and complete or incomplete transactions as well transactions governed by customary law.

The emphasis of *Fairness of Transactions Act 1993* is to try and arrive at an amicable settlement first (s 7) and if that fails, the court shall hear the matter and make such order as it thinks is fair (s 8).

Part 4: Australian Consumer Law

So, what does the Australian Consumer Law look like if something similar were to be legislated for in PNG? Here is a brief overview.

If you want to see what the Australian Consumer Law looks like, see Schedule 2 on the Australian Competition and Consumer Act 2010 (Cth) website.

What is misleading or deceptive conduct?

The Australian Consumer Law contains one section (s 18) where the wording relating to misleading or deceptive conduct is very wide. The wording is:

> *A corporation shall not, in trade or commerce, engage in conduct that is misleading or deceptive or likely to mislead or deceive.*

Courts have interpreted the meaning of misleading conduct to be conduct that would lead an ordinary member of the public who reads the statement be led into error. Furthermore, misleading conduct is more than conduct that could simply result in confusion.

Note also the use of the word '**or**'. It is a splitting word ('and' is a joining word). If the section read 'misleading and deceptive conduct' then to have a breach of s 18 the conduct would have to be both 'misleading' **and** 'deceptive' for a breach of the section. But using the word 'or' means that s 18 will catch conduct that is misleading 'or' deceptive and is much wider in its application. It sets a norm of conduct. The misleading or deceptive conduct must either induce error or be capable of producing error.

Under the wording of s 18, it is not essential that anyone is actually deceived or misled; it is sufficient that the conduct is ***likely*** to mislead. For this reason, this section of the Australian Consumer Law is known as the 'umbrella section' as it can cover most situations where an aggrieved consumer wishes to take action under the Australian Consumer Law and it is perhaps the most litigated section of the Australian Consumer Law.

The main functions of the Australian Consumer Law can be summarised as follows:

- protects the interests of consumers against:
  - unfair practices of traders (things traders do to consumers)
  - unconscionable conduct of traders
  - misleading or deceptive conduct
  - specific false representations; **and**
  - unfair practices;
- provides consumer guarantees relating to the supply of goods and services
- provides safety and information standards
- establishes manufacturers' liability; **and**

- establishes product liability.

It is not uncommon to find that proceedings under the Australian Consumer Law involving allegations of a breach of a specific section will also involve a breach of the more general s 18. However, there will also be cases where there will be a breach of s 18 without necessarily involving a breach of the more specific sections. It is worth noting here that, under the rules of statutory interpretation, where both a general and a specific section apply, the more specific section usually applies.

The reason the Australian Consumer Law has both general and specific sections, is that stricter penalties apply if you can prove a breach of one of the more specific provisions. We will consider penalties a little later.

What is unconscionable conduct?

You will recall that unconscionable conduct was one of the factors which could affect the validity of a contract at common law. The Australian Consumer Law contains provisions that confirm this. In Chapter 8 we noted that unconscionable conduct was conduct that was unreasonable, unscrupulous, or excessive. And remember it often involves situations where there is a serious difference in the commercial competency of the parties. Sections 20–22 of the Australian Consumer Law deal with unconscionable transactions between a business and a consumer, and between businesses (but not listed public companies).

What are consumer guarantees implied in contracts? (51-64)

The Australian Consumer Law created a new concept in consumer protection law when it was introduced and that was the replacement of conditions and warranties with non-excludable consumer guarantees. This was considered by the Review Committee that could be incorporated into new consumer protection legislation in Papua New Guinea.

The matters covered by these guarantees are considered to be so fundamental to a consumer contract that they don't have to be put in writing or even stated by the parties, for them to be considered as part of the contract. While the notion of a consumer guarantee is new, the underlying principles are not, as previous consumer protection legislation in Australia provided for what were known as implied conditions and warranties. What the Australian Consumer Law does, though, is simplify the law and create language that is more readily understood by contemporary consumers.

These implied guarantees relate to contracts for the provision of both goods and services. For **goods**, the main implied guarantees are:

- Goods must be of acceptable quality.

- Goods must be fit for their purpose, when you have made their purpose known to the seller.
- Where goods are sold by reference to description, it is implied that the goods will correspond with that description (and also correspond with a sample, if a sample is also provided).

For **services**, the three implied guarantees are that services will be:

- Rendered with due care and skill.
- Fit for a disclosed purpose.
- Supplied within a reasonable time (if no specific time for supply is stated).

Section 64 of the Australian Consumer Law expressly prohibits the consumer and the supplier from agreeing to exclude the operation of the consumer guarantees. Such term will be void. However, s 64A does provide exceptions to the rule in s 64 in business-to-business dealings and situations where the consumer can establish that it was not fair or reasonable for the supplier to rely on that term of the contract.

What remedies, penalties and defences are available under the Australian Consumer Law?

Don't get too bogged down in the detail here. Remember this section in only intended to show you what the Australian Consumer Law covers and possible remedies and penalties that could apply for breaches of consumer protection laws. The essential things to note are that some of the sections of the Australian Consumer Law attract fines as well as civil remedies for consumers. Note though that the courts will try to award civil penalties – that is, award damages by way of compensation, rather than impose fines. Currently, fines are A$50 million per breach, and for individuals (including directors and managers involved in a contravention) A$2.5 million per breach for making false or misleading representations, for unfair sales practices such as bait advertising, harassment and coercion, and for unconscionable conduct. As an exercise, try converting these fines into Kina.

Remedies available to a consumer, and a court or tribunal, include damages, compensation orders, undertakings, substantiation notices, public warning notices, injunctions, disclosure of information, orders for non-party consumers, and non-punitive orders.

Defences to alleged breaches of any of the sections attracting criminal penalties are:

- reasonable mistake
- reasonable reliance on information supplied by another person
- the breach was due to the act or default of another person or beyond defendant's

control.

Defendants must be able to show that reasonable precautions were taken not to mislead or deceive consumers and it is not a defence to blame an employee, director or agent.

Key points

An understanding of the following points will help you to better understand and revise the material in this chapter.

- **What are the current consumer protection laws in PNG?:** the *Goods Act 1951*, the *Independent Consumer and Competition Commission Act, 2002* , and the *Fairness of Transactions Act 1993*.

Part 1: The Goods Act *1951*

- **What are implied terms?:** implied terms are terms that are not expressly stated in a contract but which the law implies are included in the contract and are enforceable.
- What are the requirements for the formation of the contract? – three elements are required:
  - goods; **and**
  - money consideration (called the price); **and**
  - transfer of property
- **What are 'goods?:** goods are broadly defined to includeall chattels personal other than things in action and money' (s 1(1) and generally only includes only physical and movable things).
- **What is the importance of transfer of ownership?:** risk of loss of the goods goes with the person who has the ownership in the goods.
- **What is the difference between a sale and an agreement to sell?:** in a sale of goods,ownership (or property) transfers from the seller to the buyer at the time of the contract, (an executed contract) while in an agreement to sell, property in the goods is to be transferred at some later date, or when some condition has been fulfilled.
- **Are there any formalities to be observed in making a contract of sale?:** there are no special formalities to be observed but for the *Goods Act 1951* to operate the goods must be of a value of K20> and you, as the buyer, have accepted part or all of the good, or paid a deposit, or there is a written note or memorandum of the contract showing the names of the parties, the subject matter, the price and the buyer's signature.

- **What are the terms of the contract?:** the implied terms contained in the *Goods Act 1951* are framed as conditions or warranties.
- **What are the terms implied in the *Goods Act 1951*?**
  - **title (s 13):** in the case of a sale and agreement to sell, an implied conditionthat the seller has a right to sell the goods and implied warrantythat you will enjoy quiet possession of the goods and that the goods are free from any charge or encumbrance in favour of any third party.
  - **sale by description (s 14):** an implied condition that the goods will correspond with the description, or if a sale by sample and description, that the bulk of the goods will correspond with both requirements.
  - **fitness for purpose (s 15(2)(a)) and of merchantable quality (s 15(2)(b)):** where you rely on the seller's skill or judgment, and they are goods the seller normally sells, an implied condition that the goods are fit for purpose. If the goods are bought by description, an implied condition that the goods are of merchantable quality.
  - **sale by sample (s 16):** an implied condition that the bulk will correspond with the sample in quality, that the buyer will have a reasonable opportunity to compare the bulk with the sample, and that the goods will be free from any defect, rendering them unmerchantable, which would not be apparent on any reasonable examination and would cause the goods not to be of acceptable quality.
- **What is the distinction between property and possession?:** 'property in goods' means 'ownership' **or** 'title' and is a legal relationshipwhile 'possession of goods' refers to thephysical control or custody**of** the goods.
- **When does risk pass? (s 20):** risk passes when property (or ownership) passes from the seller to the buyer depending on the intention of the parties and whether the goods are:
  - existing
  - future
  - specific
  - unascertained, **or**
  - ascertained.
- **When does property pass? (s 18):** ifthe sale is forascertained or specific goods, property transfers to you when you and the seller intend it to pass (s 18(1)). To ascertain intention, look at:
  - the terms of the contract
  - the conduct of the parties; **and**
  - the circumstances of the case.
- **What is the purpose of the *Personal Property Securities Act 2011*?:** The *Personal Property Securities Act 2011* covers security interests over personal property other than land that in substance secures payment of a debt or other obligation.

- **What is a sale under a voidable title? (s 22):** If a seller has a voidable title at the time of sale, the buyer acquires a good title:
  - provided that the goods were bought in good faith; **and**
  - without notice of the seller's defective title.
- **What are the rights and duties of the parties in performance of the contract? (ss 27, 29(1)):** delivery takes place when there is a voluntary transfer of possession from the seller to you but when that takes place depends in each case on the terms agreed to between the parties.
- **What is the duty of the seller in respect of delivery? (ss 29-37):** where the contract says nothing about delivery you need to look at a number of factors including:
  - are the goods in a deliverable state? (s 29(7))
  - when and where is delivery? (s 29(2))
  - are there third parties involved? (s 29(5))
  - is delivery in a reasonable time? (s 29(4))
  - is the correct quantity being delivered? (s 30)
  - is delivery by instalments? (s 31)
  - who authorised delivery to a carrier? (ss 32(2), 33).
- **When must you accept and pay for the goods? (s 28):** your duty as the buyer is to accept and pay for them in accordance with the terms of the contract
- **When does acceptance occur? (s 35):** acceptance occurs when you have:
  - advised the seller you have accepted the goods; **or**
  - performedany act that is inconsistent with the ownership of the seller after delivery; **or**
  - waited a reasonable time.
- **What are the seller's remedies for breach of contract?:** an unpaid seller is a person who has not been paid the full price or has been paid with a cheque or bill of exchange that has been dishonoured. The seller's rights will depend on whether property or possession of the goods has passed. If they have possession, exercise a lien on the goods, or stop the goods in transit in the case of insolvency, resell the goods. If property has not passed, sue you for damages for non-acceptance.
- Can you recover damages for non-delivery? (s 51): sue the seller for damages for non-delivery or sue for specific performance if damages are not an adequate remedy.

Part 2: The *Independent Consumer and Competition Commission Act 2002*

- The *Independent Consumer and Competition Commission Act 2002* provides limited protection to consumers, mainly in relation to consumer product safety.

Part 3: Other consumer protection legislation

- The purpose of the ***Commercial Advertisement (Protection of the Public) Act 1976*** protects the public from commercial advertisements that are inaccurate or untrue.
- The purpose of the ***Packaging Act 1974*** is to protect the consumer who buy labelled or packaged goods that the goods are properly packaged and labelled, making it an offence for a person who is not authorised to mark a package stating that it is an approved brand when it isn't, or to mark a package with a copy of an approved brand.
- The purpose of the***Fairness of Transactions Act 1993*** is to ensure the overall fairness of any transaction is fair and not manifestly unfair or not genuinely mutual. The emphasis of the *Fairness of Transactions Act 1993* is to try and arrive at an amicable settlement first and if that fails, the court shall hear the matter and make such order as it thinks is fair.

Part 4: The Australian Consumer Law

This section is only intended to give you an overview of what Australia has done to try and give consumers a single national law for greater consumer protection and fairer trading by:

- protecting the interests of consumers against:
  - unfair practices of traders (things traders do to consumers)
  - unconscionable conduct of traders
  - misleading or deceptive conduct
  - specific false representations; and
  - unfair practices
- providing consumer guarantees relating to the supply of goods and services
- providing safety and information standards
- established manufacturers' liability
- established product liability; **and**
- providing heavy fines for breaches of the Australian Consumer Law. The question to consider here is whether, and when, the PNG National Government will adopt changes to the current consumer protection laws.

PART V

PART 5. AGENCY

14.

AGENCY

Learning objectives

At the end of this Chapter, you should be able to:

- explain the elements of an agency relationship
- describe the different types and relationships of agency
- discuss the appointment and sources of authority of an agent
- identify the rights, duties and liabilities of agents and principals
- identify the various means for termination of an agency agreement
- explain the remedies of a principal for breach by an agent.

Key Terms

You will notice these key terms, which are mentioned throughout the chapter, to help you to better understand and remember the material:

- **Agent:** a person employed to act on behalf of, or represent, another person (the principal).
- **Broker:** a person who buys and sells things for other people for a commission and are common in the financial world.
- ***Del credere* agent:** a person as a broker for the principal but who also guarantees payment by a third party to the principal after the transaction is completed and who may become liable for that amount.
- **Estoppel:** a legal principle that prevents a person from going back on an action or statement that they made in the past.
- **Factor:** a type of trader who takes possession of goods, or the documents of title to the goods, on consignment for a principal for commission and sell them in their own name.
- **Mercantile agent:** a person who buys, sells and consigns goods for their

principal (usually in their name) for a commission but who does not have possession or ownership (documents of title). If the mercantile agent is given possession of the goods he is known as a factor.

- **Principal:** a person who gives authority or capacity to another person (the agent) to act on the principal's behalf and create legal relations with a third party.
- **Ratification:** the legal confirmation of the adoption of a transaction by a principal of an act of their agent.
- **Secret commission:** a commission or profit which has not been accounted for by the principal and which is like a bribe and may result in both a criminal and a civil law action.

Introduction

The is the last chapter. You have learned about some of the key areas of commercial law that are very important in business, but also equally important in a lot of your day-to–day activities, starting today. In Chapter 12 we began by looking at the doctrine of privity of contract and learnt that only those persons who were immediate parties to a contract acquire rights and liabilities under it. However, what you are about to discover is that agency is an exception to the rule, and hence it is important a have a basic understanding of it. Because of the complexity of commercial dealings today, it is often necessary to deal through others including at the very least bankers, financiers, accountants, managers, partners, and solicitors. Where these persons negotiate on your behalf with third parties, they will often be your agents and they may make you liable for their actions. Just understand that the law of agency exists in specific situations where one person (the agent) acts on the authority of another (the principal) to enter into legal obligations such as contracts. The agent will have some express or implied authority as well as certain rights and duties, with the duty to act in good faith being the most important. There are various specific types of situations where a relationship of agency exists.

What is an agency relationship?

Where there is an agreement, which may be oral or in writing, between you as a principal and another person (an agent) to do something for and on your behalf,that creates a potential agency situation. It gives an agent the authority to act on your behalf, but with the benefits going to you as principal.

There is also a contract made by an agent in the exercise of their authority with a third party

which is enforceable both for and against you as principal (if an agent has acted within their authority). So, what you are looking at here is a three–party situation – you as a*principal* who passes authority to an agent to act on your behalf when dealing with a *third party*. A good example of an agency situation is a real estate agent in the purchase and sale of real estate.

Who are the parties to an agency agreement?

An agency agreement involves three parties:

- a principal who gives their authority to.
- an agent who, in turn, through the authority given to them by the principal creates the legal relations with.
- a third party.

What common types of employment relationships can you get?

Can an agency situation be created between an employer and employee?

A common type of agency situation is employer and employee. The employee is subject to the control and direction of the employer (a **contract of service**) and generally does not have the power to make contracts with third parties. However, if there is evidence of an intention on the part of the employer to give an employee managerial power – for example, a shop manager may be authorised to buy goods or services for the business, or has the power to hire and fire staff, then there is evidence of an intention on the part of the employer to give the employee power to make contracts that could bind the employer.

Can an agency situation arise from an employee–independent contractor relationship?

Generally, an employer-independent contractor relationship will not create an agency relationship. The contractor performs an agreed task specified by the employer for an agreed price, but the contractor, not the employer, controls the manner, methods, and materials needed to complete the task. Unlike the employer-employee relationship, there is usually no evidence of intention to create an agency agreement. However, there is an exception where an agent can be an independent contractor and that is in the case of an auctioneer.

Other examples of where you will come across an agency relationship include real estate

agents, partnerships, agents in the entertainment industry, brokers, factors, and *del credere agents*.

Knowing what kind of agent relationships exists is important, particularly in commercial arrangements as it determines what rights and obligations the parties have with one another.

What are the different classes of agents?

TYPE OF AGENT	DESCRIPTION
Special or limited	An agent *is authorised* to only make a particular type of contract or carry out a particular transaction on behalf of the principal - for example, you ask a friend to bid no more than K15,000 at a car auction and they bid K20,000 you as the principal are not bound because they have exceeded their authority.
General	An agent can make contracts of a certain class that are normal for this type of agency or do some act for a principal which is part of the agents ordinary course of business - for example, a manager has implied power to carry out those duties necessary for the running of the business.
Universal	An agent can do almost anything a principal can do and are usually appointed under a power of attorney - for example, a person who knows they are getting dementia might appoint a friend to pay debts, collect moneys as though they were a principal.

How can an agent be appointed?

TYPE OF AGENCY	DEFINITION	ENFORCEMENT
Express	Authority is expressly given to the agent by the principal by agreement. Can be oral, in writing (which is best), or by deed.	Principal and the third party are bound to the contract.
Implied by conduct	Authority is implied from the conduct of the parties based on an objective test of the reasonable person. Can be by partnership, and in domestic situations by cohabitation.	Principal and third party are bound to the contract.
Operation of law	Authority is imposed on parties by law in cases of cohabitation and necessity or emergency.	Principal and third party are bound to the contract.
By `ratification`	Acts are committed without a principal's authority, but the principal subsequently ratifies agent's actions must be complete *and* unconditional.	Principals and third parties are not bound to the contract unless principals ratifies the contract.

In cases of necessity or emergency,**four conditions must** be satisfied:

- there must be a genuine emergencywhere the principal's property is in physical danger;**and**
- it must be impossibleor extremely difficult to get the principals instructions; **and**
- the person must be entrusted with another's property; **and**
- A must act bona fide in the principal's interests, and not merely for an agent's own convenience.

In the case of ratification, the following conditions**must all be satisfied**, or an agent may find themselves liable to a third party for breach of warranty of authority:

- An agent must clearly be acting as an agent; **and**
- An agent must have a known principal in mind. It is not necessary that principal be named; however, principal should be capable of being ascertained at the time of making the contract; **and**
- A principal must have contractual capacity at the time of making the contract, **and**
- there should be an act capable of ratification. A contract that is void from its inception cannot be made good by ratification, **and**
- A principal must have full knowledge of all the facts at the time of ratification, **and**
- ratification must occur within a reasonable time of the contract being entered into, **and**
- ratification may be express or implied by the conduct of the principal. The only time a special form is required is for the ratification of a deed, **and**
- ratification must apply to the whole contract, **and**
- ratification can only be retrospective.

What are the sources of authority for an agent?

In brief

The sources of authority of an agent can be conferred either:

- **expressly** or by action by principal
- **implied actual**, which is inferred from the conduct of the parties, **or**

- by way of **apparent or ostensible authority** which leads a third party to believe that an agent has authority to contract on a principals behalf when this is not the case. Thus, for example, a transaction by one partner can bind the other partners if the transaction is part of normal partnership business as each partner is an agent for the other partners.

What is actual authority?

Actual or express authority of the agent will be found in the powers:

- expressly given by principal to agent
- implied in the agency agreement, **or**
- arise from the operation of law.

What is implied actual authority?

An agent has the authority to do anything that is incidental to or necessary for the carrying out of acts within their actual authority – for example, where a person acts as an agent of necessity.

What is apparent or ostensible authority?

Apparent or ostensible authority arises where principal, either by words or conduct, leads a third party to reasonably believe that agent has authority to contract on their behalf when this is not true.

The impression of conferral created by principal must be conveyed to the third party. Agent and principal may be held liable based on apparent authority if their conduct is such that it could reasonably lead a third party to believe that they could rely on that authority. Thus, in the case of a partnership, for example, look closely at the business and see whether a transaction by one partner can bind the other partner/s because each partner is an agent for the other partners.

The courts use objective evidence to establish apparent or ostensible authority including:

- the words or conduct of principal
- custom or trade usage

- situations where principal has appointed agent to perform a task that implies a certain amount of authority; **and**
- whether the position creates an impression of authority.

A good example of the use of objective evidence is *Tooth & Co v Laws* (1886) 9 LR (NSW) 154, an Australian case, where Laws was estopped (prevented) from denying that the purchaser of his hotel was not his agent by allowing his name to remain on the sign above the entrance to the hotel, with his name on it as the principal. Third parties such as Tooth & Co had not been told the business had been sold, so they had no reason to believe that they were dealing with anyone but Laws.

Reflection questions

Time for a break. Have a go at answering these 3 questions from real cases:

1. A racehorse was consigned by rail to Swaffield at one of the plaintiff's railway stations. Swaffield was not at the station when the horse arrived, as it arrived late at night. The railway company didn't have his address, so there was no way it could get in touch with him to tell him the horse had arrived. As the horse couldn't be kept at the station, it was sent to a stable at the company's expense. When the railway company sought to recover the expenses for the upkeep of the horse, Swaffield refused to pay. Do you think the railway company will succeed in their claim?
2. Lambert made an offer to buy land from an agent who in fact was manager and agent of the property on behalf of Bolton Partners. The agent had no authority to act for Bolton Partners, but he accepted the offer on their behalf. Lambert then sought to revoke the offer. Bolton Partners subsequently ratified the acceptance of the agent. The question here is whether the unauthorised actions of the agent could be ratified by the principal. What do you think?
3. Laws sold his hotel to a third party. After the sale, he allowed his name as licensee to continue to be displayed over the front door to the hotel. The persons who bought the business continued to purchase their liquor supplies, as Laws had done, from Tooth & Co on credit. Tooth & Co were not aware of the change of ownership. After several months of the new owners failing to pay their bills, Tooth & Co sued Laws for the cost of the liquor supplied. Who do you think would win – Tooth & Co

or Laws? Why?

What are the obligations of an Agent to the Principal?

The duties of an agent are based in contract law and **must** include:

- **following principal's instructions exactly:** Failure to follow these instructions will, unless an agent is prepared to ratify the transaction, not only not bind the principal but may result in an agent being in breach of contract (and quite possibly negligent), leaving an agent open to being sued for any losses that may arise.
- **act in person:** If personal confidence or skill is required, delegation is generally not possibleunless the delegation is sanctioned by the principal, it arises out of necessity or an agent's duties are purely administrative.
- **exercise due care, skilland diligence:** But, the standard of care will vary according to whether an agents services are free or paid for. If the agent charges a fee, then they are expected to exercise such care, skill and diligence that an agent in that business would have.
- **act in the principal's interest:**As the agent stands in a fiduciary relationship with the principal. If the duty of the agent clashes with the principal's interests, proper disclosure should be made. The test of what should be disclosed is what a 'reasonable' person would consider material in the ordinary course of business.
- **maintain confidentiality.**
- **keep separate proper accounts.**
- **not make secret profits or take secret commissions:** An agent is entitled only to the agreed or customary commission as payment for services that have been performed, and to nothing else. If the principal is aware of an agent being paid an additional commission by a third party and sanctions it, there is not a problem. However, often the secret commission is nothing more than a bribe, the agent may face criminal charges by the police (see, for example, Div 2A, ss 97E-97P of the *Criminal Code Act 1974*) and civil action by the principal. Under the civil law the principal may:
  - claim the commission
  - claim the commission and cancel the agency agreement
  - recover damages for any loss suffered from the actions of the agent or the party that has paid the bribe, **or**
  - recover the secret commission.

Business tip

Note that the care agents must exercise will depend on whether they are providing their services free (gratuitous) or for payment. If it is for remuneration, the higher the remuneration, the higher the standard of care, diligence and skill required of the agent.

What are the obligations of the principal?

An agent has the following rights against a principal:

- **Right to payment:** which can be fixed or implied by the agreement, plus any expenses. If an agent's services are gratuitous (free), then they are entitled to be reimbursed for any expenses. But note that if the agency agreement is that an agent will find a purchaser, or introduce a prospective purchaser, no commission is payable unless the prospective purchaser is ready, willing, and able to purchase at the principal's price and terms and enters into a binding agreement.
- **Right to indemnity:**against any liabilities and to be reimbursed for any expenses incurred in carrying out the principal's instructions. An agent loses the right to indemnity and reimbursement where agents acts are not authorised or ratified by the principal, there is a breach of duty by the agent, or the loss is due to the unlawful or negligent acts of the agent.
- **Right of lien:** is available to the agent to retain the goods of the principal until reimbursement of expenses and commission if applicable. A lien is lost if the agent voluntarily parts with possession or principals pays what they owe the agent.
- **Right of stoppage in transit:** is available for an agent where they are personally responsible for the price of goods bought on the principal's behalf because the seller is placed in the position of an unpaid seller if the principal were to become insolvent (broke or bankrupt). In such a case, an agent may be able to exercise the seller's right of stoppage in transit if the goods are still in possession of a carrier (see the *Goods Act 1951*, ss 44-48). If an agent can recover possession of the goods, then the right of lien can be exercised.

What is the liability of Agents and Principals to Third Parties?

When you think about it, agency involves two contractual situations. The first is between principals and agents while the second is the contract formed by the agent between the

principal and the third party. What is interesting here is that generally an agent cannot sue or be sued on a contract between the principal and third party.

Reflection questions

Take a break and think about how you would answer these two questions. Both are real cases.

1. Lunghi had a block of land he wished to sell. He approached Sinclair, a real estate agent, to sell the land for him. Sinclair informed Lunghi that his (Sinclair's) wife was an interested buyer, and after some time, and little buyer interest, Lunghi eventually sold the land to her. Lunghi subsequently discovered that Sinclair's wife was a partner in the real estate agency and that no real attempt had been made to sell the land. It was, in fact, worth substantially more than he was told, and Mrs Sinclair had resold the land for a significant profit. What would you advise Lunghi of his options, if any?
2. Pow appointed McCann & Co, a firm of real estate agents, to sell his flat. Without Pow's knowledge or consent, the agents gave details to a sub-agent, who subsequently sold the property. While McCann & Co were instrumental in arranging the sale, were they entitled to any commission?

In brief

As a general rule, an agent cannot sue or be sued on a contract between the principal and a third party where:

- an agent discloses the agency relationship and names of the principal, or
- an agent discloses the agency relationship but does not name the principal.

If an agent does not disclose the agency relationship or name the principal, an agent will be personally liable on the contract. A similar outcome will occur where the agent will be liable for breach of warrant of authority if the agent exceeds their authority (express or implied) given to them by the principal.

What is the legal position where there is disclosure of an agency relationship?

The general rule where agent contracts for a named principal is that agent is completely discharged from the agreement. End of story. But having said that, an agent can still incur liability if:

- they have executed a deed in their own name
- usage or custom makes them liable
- A principal is non-existent
- they agree to be liable, **or**
- they are in breach of warranty of authority by acting beyond the scope of their actual or apparent authority.

If an agent makes a contract with a third party without naming the principal, to avoid being personally liable, the agent should expressly disclose that an agency relationship exists. It is then up to the third party if they are prepared to accept an unknown principal. If they are, the agent is discharged from the contract.

If the agent does not disclose the existence of the Principal, then they may find that the third party treats them as the principal and a party to the contract or, if the third party discovers the principal's identity, sues principal (this is actually called the **doctrine of the undisclosed principal**). But the third party cannot sue both the agent and principal unless given permission by the court because to do so would potentially allow two judgments for the one debt.

What is a breach of warranty?

If an agent expressly or impliedly represents that they acted with the authority of the principal, and the third-party acts based on that representation, an agent is taken to warrant that the representation is true. If it is untrue – irrespective of whether it was

done fraudulently or innocently (and even if the authority had been terminated without the knowledge of an agent) – agent has committed a breach of warranty of authority. The third party can then sue the agent for damages to the extent of the actual loss suffered.

Always disclose that you are only an agent acting for a principal and ensure that you act within the scope of your actual or apparent authority if you want to avoid liability for:

- breach of warranty of authority; or
- any torts that you commit.

Business tip

Avoiding liability as an agent

Always disclose that you are only an agent acting for a principal and ensure that you act within the scope of your actual or apparent authority if you want to avoid liability for:

- breach of warranty of authority; **or**
- any torts that you commit.

What is the liability of the principal and agent in tort?

The principal will be liable to third parties for any tort committed by an agent if the agent has acted within the scope of the *agent's actual or apparentauthority* or *employment*, whether or not the tort was committed for the benefit of the principal.

If an agent was doing something outside the scope of the agency agreement when the tort was committed, the principal would be relieved of any liability.

How can an agency agreement be terminated?

An agency agreement can be terminated by:

- acts of the parties, or
- operation of law.

In relation to termination, any rights vested before the termination, such as an agent's right to commission or indemnity, are not affected.

If the agency is terminated by agreement, the principal is under a duty to notify those third parties with whom an agent may do or has done business. The notice can be from the principal or some other recognised source such as agent.

Termination ends agent's actual authority to act on the principal's behalf. However, if the principal fails to give proper notice of the termination to a third party, an agent still has apparent authority to bind the principal to a contract with a third party who is not aware of the termination. The contract would be enforceable against the principal, and principal's only recourse then would be to sue the agent for damages caused by the unauthorised contract.

Business tip

To avoid problems arising for the principal when the principal terminates:

- The principal should give **direct notice of termination** to the parties who deal with an agent, preferably in writing.
- The principal must give direct or give constructive notice to **any third parties** who has knowledge of the agreement but with whom the agent has not yet dealt with – for example, notice in the Public Notices section of the local newspaper. It is irrelevant whether third party sees it or not as this is constructive notice of termination of the agency to avoid liability.
- Generally, a principal is **not liable to parties who have no knowledge of the agency agreement**. However, if there is written authority of an agency relationship, to avoid possible problems arising with a third party subsequently relying on an agreement to establish liability of the principal, put a notice in the Public Notices section of the local newspaper.

What acts can the parties take to terminate an agency agreement?

Mutual agreement

While the agreement between a principal and agent is still in force, they may mutually agree to its termination.

Revocation of the agent's authority

Revocation can be done at any time by the principal without an agent's consent, even

though the work of an agent may not be completed. However, this could lead to a breach of contract and an agent bringing an action for wrongful dismissal. Third parties should be notified by the principal to avoid any problems arising from an apparent agency.

Withdrawal of the agent from the agreement

This can be done at any time, but an agent will need to make good any loss that the principal may suffer. An agent is not liable for any loss where the agency is a gratuitous one – that is, there is no commission involved.

Secret commission

An agency may be terminated by the principal if the principal discovers an agent has accepted a secret commission.

Completion of a specific purpose or act agency

Where an agent is appointed for a specific purpose and that purpose has been completed, the agency agreement will be terminated by performance – for example, the sale of a house by a real estate agent.

Time limit

If there is a time limit involved in the agency agreement and the act is not achieved within that time limit, the agency agreement will be terminated – for example, a real estate agent who has 60 days to achieve the sale of a house.

Operation of law

Performance

An agent's authority continues only up until the purpose for which the agency agreement was created has been completed.

Lapse of time

Where an agent has been appointed for a specific time, then the authority of an agent ceases when the time period expires.

Death

The death of the principal brings the authority to an end. But where the agent is acting in good faith under the scope of a power of attorney, any acts done after the death of the principal, but before notice of the death reaches the agent, are valid and the agent will not be held liable.

In the case of the death of an agent, whether the agreement is terminated will depend on whether the agreement is for the provision of personal services or not. If it is for personal services, then the agency is terminated.

Insanity

Insanity of either the principal or agent terminates the agency agreement.

Bankruptcy

In certain cases, bankruptcy of either the principal or the agent under the provisions of the *Insolvency Act 1951* will terminate the agency agreement.

Frustration

Where it becomes impossible for the agent to carry out their obligations owing to the destruction of the subject matter, or by any event that makes the agency illegal or impossible to perform, this will terminate the agency agreement (see also Chapter 12).

What remedies are available to a principal for breach by an agent?

The major remedies available to the principal for a breach by the agent of an agency contract are the same as a breach of any contract. These include:

- rescission (see Chapter 12 'Discharge and breach of contract')
- refusing to pay a commission (check the agreement carefully because the agreement with the agent will often contain a term entitling an agent to their commission even when the purpose of the contract is not carried fulfilled)
- suing for damages (see Chapter 12 'Discharge and breach of contract'), **and**
- suing the agent for recovery of a secret commission.

What are some common types of agency?

This is for your information to illustrate the types of situations where an agency arrangement is commonly found:

- employer-employee (where there is evidence of intention to give an employee power to make contracts and it is within the scope of their employment)
- auctioneer
- mercantile agents
- Brokers – for example, insurance brokers, stock brokers, financiers
- *del credere* agents
- partners
- real estate agents; **and**
- partners in a partnership.

It is worth noting that where an auctioneer is concerned, they are the selling agent of land/property or goods for the owner. There may be a '*reserve price*' on the land or goods and this is the minimum price below which the seller is not prepared to sell. In other words, the auctioneer's authority is limited by the setting of a minimum price and at some point, either before or during the auction, those in attendance at the auction will be advised there is a minimum price.

If the auction is '*without reserve*', that means there is no minimum price and the auctioneer must accept the highest bona fide bid on the fall of their hammer.

Business tip

An auctioneer is an agent of the vendor (the seller), but after the fall of the hammer they become the agent for the purchaser. If attending an auction as a buyer note carefully whether the auction has a 'reserve' or 'no reserve' on it.

Reflection question

Take your final break, as this is the last chapter. Reflect on how you would answer this last question.

Harrison, an auctioneer, advertised an auction of horses as being 'without reserve'. This meant that the highest bona fidebidder should have been the successful bidder, whatever the price bid. At the auction, Warlow submitted a bid but the owner of the mare he bid on submitted a final higher bid that the auctioneer accepted. The plaintiff then sued the auctioneer, alleging a breach of the auctioneer's contractual obligation to sell the horse to the highest bona fide bidder. Do you think the plaintiff would be successful in an action against the auctioneer? Explain why.

Key points

An understanding of the following points will help you to better revise material in this chapter.

- **What is the purpose of agency?**
  - An agency is a relationship whereby one person (the **agent**) is authorised by the other person (the principal) to do certain acts that affect the principal's legal rights and duties to third parties.
  - Only those persons with full contractual capacity can employ an agent.
  - An agent cannot have greater powers than the principal possesses.
  - If the principal is under some legal disability, an agent is equally limited.
- **How is an agency relationship created?**
  - Expressly:
    - by necessity
    - by emergency; **or**
    - by holding out or estoppel.
  - Impliedly:

        - by necessity
        - by emergency; **or**
        - by holding out or estoppel.
    - Ratification: The principal may accept liability for the agent's actions after the agent has acted.
- **What is the authority of an agent?**
    - Actual authority: if the agent follows instructions and acts within the authority delegated by the principal, an agent will be acting within actual authority. When an agent acts within actual authority, an agent will bind the principal to third parties and never be personally liable to the principal or the third party.
    - Apparent (or ostensible) authority: by appointing a person to a particular position, the principal may give an agent the appearance of greater authority than has actually been delegated to the agent. If an agent acts outside the actual authority but within this appearance of authority, an agent will bind the principal to the third party and be liable to the principal for any loss the principal suffers as a result of the agents failure to follow instructions.
    - Warranty of authority: no one is liable for acts done on their behalf without their actual or apparent authority. If a person claims to act as an agent, they impliedly warrant that they have authority from the person for whom they claim to act. If in fact the agent is acting without any authority or in excess of their authority, they will be liable to the third party in damages for breach of warranty of authority. An agent isn't liable where the third party is aware of the lack of authority, or where the agent has told the third party that they didn't warrant their authority.
- **What is the agent's duty to the principal?**
    - Agent's duty is to:
        - follow instructions
        - act in person
        - act in the interests of the principal (fiduciary duty)
        - take care of the principal's property
        - keep separate accounts; **and**
        - keep proper accounts
- **What are the agent's rights against the principal?**
    - Agent's rights are:
        - remuneration
        - reimbursement for out-of-pocket expenses
        - indemnity against legal action; **and**
        - lien and stoppage in transit.
- **What is the liability of agents and principals to third parties?**
    - The liability of the agent:
        - Where the agent contracts for a named principal, an agent is completely

discharged and cannot incur either liabilities or rights.
        - Where there is a named principal, an agent is discharged.
        - Where there is a disclosed but unnamed principal, an agent is again discharged.
        - In the case of an undisclosed principal, as an agent has contracted in their own name and the third party may not be aware of the existence of a principal, an agent may be personally liable. When the principal is discovered, the third party may sue either principal or agent.
        - While an agent is saved from personal liability where any actions were within authority, actions outside authority can expose an agent to an action of breach of warranty of authority by the third party.
        - An agent is liable for tortious acts, such as negligence, but where those acts are committed within the course of the agent's employment, the principal will also be liable.
    - Where anagent is liable to third parties:
        - when contracting under seal (the contract is in the form of a deed) in their own name
        - when professing to act as an agent, when in fact they are the principal
        - where it is the custom or trade practice for this to apply
        - where there is a declaration that agent is acting personally
        - where the agent is acting on behalf of a principal who does not exist
        - where the agent has some interest in the contract other than commission; **or**
        - in the case of wrongful acts known to be wrongful and not within the scope of authority.
    - When principal is liable:
        - to perform what an agent has promised to a third party when acting according to an agents authority
        - to third parties where an agent has acted beyond authority, but in the ordinary course of the agency; **and**
        - for frauds and wrongs of an agent committed in the ordinary course of employment.
- **How can an agency be terminated?An agency can be terminated by:**
    - mutual agreement
    - revocation of the agent's authority by principal
    - the agent terminates by notification
    - serious misconduct by agent
    - expiry of the agreed term
    - performance
    - the death of the principal or agent
    - bankruptcy of an agent

- the mental incapacity of the principal or agent
- frustration – unknown to the parties the subject matter of the contract has been destroyed or an agent is physically unable to carry out their duties.

GLOSSARY OF TERMS

An A-Z list of key terms used throughout this book.

- **Acceptance:** an unqualified assent given in response to an offer, which creates an agreement.
- **Actual breach:** failure at the time required by the contract.
- **Agent:** a person employed to act on behalf of, or represent, another person (the principal).
- **Agreement** – one of the requirements for the creation of a contract, normally consisting of an 'offer' and an 'acceptance', which may arise expressly or be inferred from conduct, between two or more people.
- **Agreement to sell:** where the property in the goods is to be transferred at some later date, or when some condition has to be fulfilled, such as payment of the price.
- **Anticipatory breach:** the threatened failure to perform and can occur expressly or by implication.
- **Anton Piller order:** an order that is available only where it can be shown that the defendant has incriminating evidence that is necessary to the plaintiff's case and which may be destroyed before 'discovery' can be made.
- **Ascertained goods:** goods which, in a contract for the sale of unascertained goods, have become identified and agreed on by the parties.
- **Assignment:** transfer.
- **Beneficial contracts of service:** contracts that are for the minor's benefit and are not oppressive, including employment, education, apprenticeship and training contracts.
- **Broker:** a person who buys and sells things for other people for a commission and are common in the financial world.
- ***Caveat emptor:*** is Latin for 'let the buyer beware' and means that the buyer is buying the goods at their own risk.
- **Chattels:** any property other than freehold land; articles of personal property.
- **Chose in action:** a personal property right to an intangible object such as a debt.
- **Civil law system**: a complete legal system with its origins in Roman law and the Napoleonic Code.
- **Collateral contract:** a separate or subsidiary contract to the main contract, which may be verbal or written, and which exists independently of the main contract (that is, it is not a term of the main contract
- **Common law:** that part of English law developed from the common custom of the country as administered by the common law courts.

- **Common mistake:** both parties are mistaken as to existence or identity of the subject matter
- **Condition** – a stipulation going to the root of the contract, allowing the injured party the right to rescind and/or claim damages
- **Condition precedent:** a precondition that, depending on its analysis, stops a contract from coming into existence until the occurrence of some specified event.
- **Condition subsequent:** a term of the contract that must be complied with after the contract is made or the other party can terminate for non-fulfillment.
- **Consideration:** the 'price' paid to buy the other person's promise; it must be in every simple contract.
- **Contract** – an agreement containing promises made between two or more parties, with the intention of creating certain rights and obligations, which is enforceable in a court of law.
- **Contract for the sale of goods:** under the *Goods Act*, a contract whereby the seller transfers, or agrees to transfer, the property in goods.
- **Contributory negligence:** negligence by the plaintiff that has contributed to their loss, damage or injury.
- **Corporation:** a legal entity (also known as a legal person) created by the *Corporations Act 2001* (Cth); also known as a 'company'.
- **Counter-offer** – an offer made in response to an offer which implies rejection and terminates the original offer.
- **Customary law:** the term used to describe the common law rights and interests of tribal people in land according to their laws, traditions and customs.
- **Damages:** compensation in monetary form for the loss suffered by the plaintiff, which puts the plaintiff back in the position they would have been in had the breach not occurred.
- ***Del credere* agent:** a person as a broker for the principal but who also guarantees payment by a third party to the principal after the transaction is completed and who may become liable for that amount.
- **Divisible contract:** a contract that is capable of being divided into separate parts.
- **Duress:** threats of, or use of, force that deprives the innocent party of exercising their free will
- **e-contract** – a contract created electronically in the course of e-commerce, generally by email or SMS.
- **Equity:** fairness or natural justice.
- **Escrow:** an assurance in the form of a deed, money or bond held by a third party on behalf of two transacting parties that the transaction can be completed.
- **Estoppel:** a legal principle that prevents a person from going back on an action or statement that they made in the past.
- **Exclusion clause** – a contractual term that attempts to limit or exclude the liability of

the person inserting the term into a contract

- **Exemplary damages:** punitive damages.
- **Existing goods:** goods owned or possessed by the seller at the time of the contract.
- **Expectation damages:** (also known as 'expectation losses') arise from your expectation of prospective benefits arising out of or created by the contract.
- **Factor:** a type of trader who takes possession of goods, or the documents of title to the goods, on consignment for a principal for commission and sell them in their own name.
- ***Force majeure*:** clause operates to suspend a party's obligations under a contract when an event occurs that is outside their control, causing them to be incapable of carrying out their obligations under the contract for the period of the event.
- **Form** – in the sense it is used in contract law, those statutory procedural requirements that need to be satisfied for some contracts to be enforceable
- **Formal contract or deed** – a contract that has been signed, sealed and delivered, and does not require consideration.
- **Frustration:** the discharge of a contract rendered impossible to perform because of the operation of external factors beyond the contemplation of the parties.
- **Future goods:** goods to be manufactured or acquired by the seller after the making of the contract for sale.
- **Goods:** broadly defined, all 'chattels personal other than things in action and money'. This generally includes only physical and movable things, ownership of which transfers to the buyer for a money consideration, called the price.
- **Gratuitous promise:** a promise undertaken voluntarily and lacking consideration, so is not enforceable in court.
- **Infant:** a person under the age of 18 years; also known as a 'minor'.
- **Injunction:** a discretionary remedy in equity restraining a party from doing something.
- **Intermediate or innominate terms** – contractual terms, the remedy for the breach of which depends on the seriousness of the breach rather than on the classification of the term as a condition or a warranty
- **International law**: that body of law concerned with regulating conduct between nation states.
- **Joint and several liability:** where two or more persons agree together, as well as having made separate agreements to repay the loan individually.
- **Joint promises:** where two or more persons jointly agree to provide consideration jointly and both can be sued, that is, A and B promise to pay C K100.
- **Legal tender:** currency that may be lawfully tendered in payment of a debt.
- **Liquidated damages:** an agreed sum based on a genuine pre-estimate of the actual loss that would be suffered by the plaintiff in the event. of a breach of the contract.
- **Market overt:** an open, public, and legally constituted market regulated by the rules framed by a local government.

- **Mercantile agent:** also known as a 'factor' is a person who has authority to buy and sell goods, or consign them, on behalf of his principal.
- **Misrepresentation:** a false statement of fact, which may be intentionally or unintentionally made
- **Mitigation:** the steps taken by the plaintiff to minimize their loss.
- **Municipal (or domestic) law:** that body of law concerned with regulating the relations or conduct between individuals and organisations within a state's borders.
- **Mutual mistake:** where both parties to a contract are mistaken, but about different things
- **Necessaries:** goods or services that are reasonably necessary to the 'station in life' of an infant and their actual requirements (defined in the *Goods Act 1951*, s 4)
- **Negligence:** an indirect interference with the person or property of the plaintiff
- **Negligent misstatement:** a false or inaccurate statement of fact made by a person recklessly or knowingly that there were no reasonable grounds for such a belief
- **Nominal damages:** compensation awarded where the plaintiff's rights have been infringed but they have suffered no actual loss
- ***Non est factum:*** 'not my doing' or 'not my deed'; where a party under a disability is mistaken about the very nature of a document that they are signing, believing it to be one thing when in fact it is something quite different
- **Novation:** the substitution of a new contract for an old one; the new contract extinguishes the rights and liabilities that were in effect under the old contract
- **Objective test:** would the words or conduct of the parties lead a reasonable person to believe, on the balance of probabilities, that legal relations were intended
- **Occupier's liability:** as an occupier of premises, whether you own or rent, if you have control over the property, you must take reasonable care to ensure anyone who comes onto your premises is reasonably safe, although what is reasonable will vary according to the circumstances
- **Offer** – a communication amounting to a promise to do (or not do) something
- **Offeree** – the one to whom an offer is made
- **Offeror** – the one who makes the offer
- **Ordinary damages:** the amount awarded by the court on its assessment of the loss suffered by the plaintiff as a result of the breach
- **Organic law:** defined in s 12 of the PNG Constitution as laws passed by the National Parliament and which have the status of constitutional laws and are superior to an Act of Parliament
- **Parol evidence rule** – A rule of evidence which states that additional oral evidence is not considered by the courts to contradict, vary, add to or subtract from its terms when a contract is complete on its face
- **Penalty:** in contract, a damages clause that is not a genuine pre-estimate of the actual damage or loss suffered by a party as a result of the breach

- **Personal property:** any property that is not land, buildings or fixtures to land such as cars, boats, furniture
- **Plaintiff:** the party commencing a civil action in a court of first instance
- **Possession of goods:** the control or custody of goods
- **Presumption:** a belief (as the word is used here it is a reference to what the courts assume)
- **Principal:** a person who gives authority or capacity to another person (the agent) to act on the principal's behalf and create legal relations with a third party.
- **Private law:** that body of law concerned with regulating the relationships between individuals within the state—for example, contract law and tort law
- **Privity of contract:** only those who are a party to the contract are affected by it
- **Product liability:** as far as manufacturers are concerned, at common law they owe a duty of care to consumers who purchase their goods and that the goods are fit for purpose. There is an overlap here with the Goods Act 1951 and the Independent Consumer and Competition Act 2002 which provide protection for the consumer
- **Promisee:** the person who is receiving, or the recipient of, the promise
- **Promisor** – the person undertaking the promise
- **Property in goods:** ownership of, or title to, goods
- **Public law:** that body of law concerned with the relationship between the state and the individual—for example, criminal law and constitutional law
- **Quantum meruit:** an equitable remedy that means as much as a person has earned or as much as that person deserves
- **Ratification:** the legal confirmation of the adoption of a transaction by a principal of an act of their agent
- **Rectification:** an equitable remedy to correct an omission in a written contract that both parties had failed to correct by mistake at the time of making the contract
- **Rejection** – occurs where the party to whom the offer was made (the offeree) tells the party making the offer (the offeror) that they are not accepting the offer, which terminates it
- **Reliance damages:** (or 'wasted expenditure damages') arise from expenditure incurred by you relying on the defendant's promise and which is wasted because of the defendant's breach
- **Representation:** a statement of fact
- ***Res ipsa loquitor* ('the facts speak for themselves'):** a doctrine that provides that the elements of duty, breach and damage can sometimes be inferred from the nature of the accident even though the exact act of negligence cannot be exactly identified
- **Rescission:** a common law or equitable remedy that entitles the injured party to elect to rescind the contract and restores the injured party to their pre-contractual position
- **Restitution:** an equitable remedy available for the unjust enrichment of the defendant at the plaintiff's expense

- **Restraint of trade** – an agreement in which a party agrees to restrict or restrain their activities in the future to carry on their trade, profession or business with other persons who are not a party to the contract
- **Retrospective laws:** laws that change what people's rights were in the past
- **Revocation** – occurs where the offeror withdraws an offer, which then terminates it
- **Romalpa clause:** a retention of title clause that is often used in contracts for the sale of goods that title remains with the seller until the buyer meets a predetermined condition such as payment of the purchase price
- **Sale of goods:** the transfer of ownership (or property) from the seller to the buyer at the time of the contract
- **Secret commission:** a commission or profit which has not been accounted for by the principal and which is like a bribe and may result in both a criminal and a civil law action
- **Separation of powers:** the vesting of the legislative, executive and judicial arms of government into three separate branches with none of the three branches able to exercise total power
- **Several liability:** where two or more persons agree to provide consideration but each promises separately, that is, A promises to pay K50 to C and B promises to pay K50 to C
- **simple contract** – a contract that is made orally or in writing (or both) involving an agreement between parties with the intention of creating legally enforceable obligations and which requires consideration to be valid
- **Social agreements:** agreements made between friends or acquaintances
- **Specific goods:** goods identified and agreed on at the time of the contract of sale
- **Specific performance:** an equitable remedy compelling a person to carry out their contractual obligations where damages would be an inadequate remedy for breach of the agreement. It is not obtainable for contracts of personal service
- **Standard form contracts** – contracts that incorporate terms of a standard nature, often in fairly wide terms, applicable to all persons making a particular type of contract
- **Statute law:** laws passed by Parliament
- **Strict liability:** liability regardless of fault where the defendant is held liable even though they were not at fault
- **Termination** – bringing the contract to an end before it is fully performed
- **Tort:** a civil wrong other than a claim for a breach of contract
- **Unascertained goods:** goods that are defined by description only. They are not identified when the contract is made, and they may or may not be future goods
- **Unconscionable contract:** an unfair or unjust contract
- **Undue influence:** the improper use of power
- **Unilateral mistake:** where one party is mistaken about some aspect of the contract, but the other party is not

- **Unliquidated damages:** (also called ‘general damages’) damages for a loss, where the value of the loss cannot be accurately determined or exactly calculated
- **Variation clause:** often a clause within a contract (but can be oral) where both parties agree to change part of a contract from the way they originally agreed to while the remainder of the contract remains unchanged
- **Vicarious liability:** where a person is held responsible for the acts or omissions of another even though they may not have personally been at fault, for example, employer and employee
- **Void** – of no legal effect
- **Voidable** – an agreement that may be affirmed or rejected at the option of one of the parties
- **Voluntary agreements:** agreements where the parties volunteer their services, usually for no money
- **Voluntary assumption of risk:** where the plaintiff freely and voluntarily understood and assumed the risk that caused the injury.
- **Waiver:** one party leads the other to reasonably believe that strict performance will not be insisted on
- **Warranty** – a term of lesser importance to the main purpose of the contract which, if breached, only allows.

GLOSSARY OF ICONS

An A-Z list describing the icons used throughout this book.

 Answers

Brief

 Business tip

 Example

 Introduction

 Key points

 Objectives

 Questions

 Reflection

Revision


Summary


Video reference

REFLECTION AND REVISION ANSWERS

As you read through the Chapters, you will find several Revision Questions in each chapter for you to attempt. They are revision questions for you to find out whether what you have read, you understand. Attempt as many as you can as they will help you in your understanding of the law.

You will find that some of the questions do not have a detailed answer. That is because they are what are called 'Opinion' questions. That is, they are questions where there is no right or wrong answer. What these questions are trying to do is to get your thoughts on a particular topic and, importantly, why you think the way you do.

Note: The answers to the questions will follow the order in which they appear in each chapter.

Chapter 2

Think about your country for a moment. Do you think PNG is a highly regulated country? Look at the type of regulatory framework currently in place.

This is really an opinion question asking you 'What do you think?' Is PNG a highly regulated country, can you explain why.

Common law ceases to be common law when it becomes codified. What does this mean?

Begin by explaining what common law and statute law are, and then what codified means.

Parliament and the courts are independent of each other. Common law is law that is derived from judicial decisions of the courts by judges using precedents and statutes.

Parliament can create and change the law by way of statutes and statutory regulations. Parliament can override or codify the common law, which means collecting and arranging judicial decisions and pre-existing legislation according to topic matter into codified or statutory form. In law, the effect of codification is to replace existing common law rules, not creating new laws.

Common law can exist without equity, but equity cannot exist without common law. Can you explain why?

In this question begin by explaining what common law and equity are. Then explain whether equity can exist with/without Common law.

Common law is the law developed from custom and out of the decisions (case law or precedent) of judges in the 'superior' courts. In PNG, this would be the National and Superior Courts.

Equity is a system of law in its own right. It accepts common law principles and rights but it overrides them where it would be unjust or unconscionable to rely on the common law.

What is the main remedy in a common law action?

Damages.

In the event of a conflict between statute law and common law which takes precedence and why?

Statute law takes precedence over common law. Common law has its source in the decisions of judges who are independent of Parliament and the people. The common law will only be maintained to the point where it conflicts with a statute.

Statute law is law made by Parliament in the form of Acts and regulations. Unlike the judiciary, Parliament is made up of politicians who are people elected by, and answerable to, the people who elect them through the electoral process. If people don't like the laws that the politicians make, they can vote them out at election time. There is an element of accountability, as far as politicians are concerned, which is absent in the case of judges.

What is Organic Law and why is it important in the PNG?

Explain what 'Organic Law' is first and then explain why it is important.

Organic law is a set of foundational laws or regulations that have the status of constitutional

laws and along with the Constitution are the supreme law-making law of PNG. subject to section 10 of the Constitution (construction of written laws), all acts, whether legislative, executive or judicial, that are inconsistent with these documents are, to the extent of the inconsistency, invalid and ineffective.

Organic Laws are defined in s. 12 of the PNG Constitution as laws made by Parliament that are:

'(a) for or in the respect of a matter provision for which by way of an Organic Law is authorized by this Constitution; and

(b) not inconsistent with this Constitution; and

(c) expressed to be an Organic Law'.

The Constitution and the Organic Law together regulate the legislative powers of the national, provincial and local-level governments with each level having its own distinct law-making powers. The law-making powers of the National Parliament law-making powers are covered in s. 41 of the Organic Law, the provincial legislatures are outlined in s. 42, and local government powers can be found in s. 44.

What is customary law and why is it important in PNG?

First, explain what customary law is and then explain its importance.

Custom or customary law is the rules and practices that govern the native people in society in their way of life and their rules and responsibilities that they must abide by in their society. Schedule 1.2 of the PNG Constitution, s 1 of the *Interpretation Act 1975*, and s. 1 of the *Underlying Act 2000* all use the same definition of custom as "*the usages of indigenous inhabitants of the country existing in relation to the matter in question at the time when and the place in relation to which the matter arises, regardless of whether or not the custom or usage has existed from time immemorial".*

The Constitution and the *Underlying Act 2000* both provide that in the absence of written law, the courts must develop the underlying law, drawing first on customary laws and usages, and only then on common law and equity. The reason lies in the very diverse society that exists in PNG with over 1,000 customs found in different areas, each with its own customary laws that guided them in their way of life. Schedule 2 of the Constitution gives formal recognition to the importance of the role custom play in PNG society in the development of an underlying law, particularly in areas of Family Law and property.

What does the phrase 'Ignorance of the law is no excuse' mean to

you?

Just note that this question is asking you for your opinion. So there is no set answer. So begin by explaining what you think the expression 'ignorance of the law is no excuse' means and then go on and explain what it means to you.

Is it reasonable to expect that everyone knows the law? Do you? How do you overcome this problem?

Really, another opinion question, so no right or wrong answer. Do you think it is reasonable to expect everyone to know 'the law'? Remember the question is asking you how much law you do know. Then comment on whether the problem can be overcome, for example, by education, or by the government carefully explaining what the purpose of an Act is. Will that solve the problem? What do you think?

Explain why an understanding of different legal systems around the world might be useful for you in business.

Again, a question asking for your opinion if you are in an import/export business. What do you think are the benefits of having an understanding of other legal systems is?

Understanding other legal systems you might be considering doing business with can help you avoid liability and at minimise, risk. It is very important to understand the environment in which you are planning to do business because minimizing liability exposure and avoiding legal disputes must be a primary concern for those in business.

Legal systems vary widely around the world in their aims and the way they resolve disputes. For a business to succeed, it is important to understand how other legal systems law apply the law, how each country's legal system presents its own unique set of rules, and how the political systems of each country work, as they make the law.

Why do you think it important to know what the term 'person' means in law?

Begin by explaining what the term 'person' means and from that you should be able to go on and explain its importance in law

'Person'in law means any human being but also includes any entities or legal persons that are created by statute that are capable of suing or being sued such as companies, partnerships, trusts, and even government agencies, and who have certain rights and

responsibilities under the law. They have the ability to enter into contracts, own property, sue and be sued, and can be held accountable for their actions.

Why is it important to understand the difference between international and domestic law in business?

Begin by explaining what the terms 'international business law' and 'domestic law' mean and then explain why it is important to understand the difference.

International business law governs business *between countries* on a global scale and as no two states have identical legal systems, it is important to understand what the legal differences are between jurisdictions. Depending on what the business intends to do, for example, to enter into a trade agreement to import and/or export goods or service, or to set up a business in another country, businesses must understand and comply with the various legal systems to ensure not only trade laws and regulations compliance, conventions, and treaties, but also domestic legislation and commercial customs which together govern international business transactions.

Domestic business law refers to the legal framework established within a country and how it regulates how *business is to be conducted within a country*. It regulates the behaviour of individuals, organisations, and governments within its borders and is primarily concerned with maintaining order, protecting individual rights, and resolving disputes within the country.

Together, and understanding of, and compliance, with international business law and domestic business law helps businesses minimise exposure to legal exposure in the form of litigation, and avoid trade disputes.

Why do you think an understanding of the main principles underlying each source of law is important when trying to understand how the law and business interact?

Note that the question is asking what your opinion is as to why an understanding of the main principles underlying each source of law in PNG is important. So begin with what you think are the main sources of law and then how it helps you understand how law and business interact.

An understanding of the main principles underlying each source of law provides a framework for understanding how and why each source of law has evolved, ensuring consistency and predictability in legal outcomes and shaping the way business is conducted. For business, an understanding as to the how and why of each source of

law helps businesses comply with applicable laws and regulations, as well as providing guidance on risk management issues.

What reasons can be put forward to explain why the PNG National Constitution has undergone change at least 43 times since its inception in 1975?

This is a Discussion Question with no set answer. It is seeking your opinion. Why do you think there have been 43 amendments?

Why do you think the PNG Constitution has changed at least 43 times since it was formally adopted in September 1975, the last time in 2016? Is it a 'living' document that is still evolving as PNG is evolving? Look at the Constitution (http://www.paclii.org/pg/legis/consol_act/cotisopng534/). In 1975 was PNG ready for self-government and political independence from Australia? Did the highland tribes need more time to grasp the idea of nationhood. But has that changed?

What do you think is the purpose of having a Constitution? Do we even need one?

Another opinion question. Think about why you have a Constitution and then think about whether it is really necessary.

PNG's Constitution is what is called a codified constitution because it is incorporated into a written document, and its purpose has historically been to limit the power of government. It is simply a set of rules that set out how power is distributed between the Executive, Parliament and the judiciary. These rules structure the government of a state. Without such a set of rules, the state could not function and anarchy would reign. Without a constitution the power of government is unlimited. It can be argued that what a constitution produces is order but does it? Look at the PNG Constitution and see what it covers.

Is the Constitution too complicated and should it be simplified? Explain why?

Yet another opinion question and with no 'right' or 'wrong' answer. What do you think? The PNG Constitution certainly covers a lot of topics.

This is a Discussion Question with no set answer. Why do you think the PNG Constitution has changed at least 43 times since it was formally adopted in September 1975, the last time in 2016? Is it a 'living' document that is still evolving as PNG is evolving? Look at the Constitution (http://www.paclii.org/pg/legis/consol_act/cotisopng534/). In 1975 was

PNG ready for self-government and political independence from Australia because its people, especially in the highlands, needed time to grasp the idea of nationhood. But has that changed?

If you had the power, what would you change in the Constitution? Explain why?

An opinion question and there is no 'right' or 'wrong' answer. The question is asking you what YOUR opinion is on the Constitution. Is it too broad, too narrow, does it adequately deal with the problems PNG currently have.

Chapter 3

If you are injured because of the actions of another person, would your preference be to take action against the person who injured you in tort law or criminal law? Explain why.

Begin by explaining what each action involves, that is, tort law and criminal law, and that will answer the question. Remember that tort law is about a civil action and criminal law is about punishing the wrongdoer.

Both tort law and criminal law seek to impose duties on people, but they do it in different ways and with different outcomes**.** Tort law is private in nature in the sense it is brought by you as you are the person who has suffered some form of loss or damage and you are now seeking compensation, usually in the form of monetary compensation (or damages) from the person who caused that loss or damage.

Criminal law, on the other hand, is principally public in nature, as breaches are enforced and 'prosecuted' by the state, and the outcome for the wrongdoer is punishment, generally imprisonment and/or a fine.

I would assume that normally you would want compensation and so bring a tort action such as trespass to the person – assault and battery.

Problem answer

A problem question and note carefully what you are being asked to do. Note that the question is asking you who owes a duty of care when there is an activity involving

a recreational activity– the resort? The lifeguards? No-one? Begin by explaining that this is a possible negligence action and that to succeed you need to establish duty, breach and damage. At this point, the case is really about the question of who owes a duty of care, so explain what a duty of care means and apply the facts. The facts raise a couple of other issues that are dealt with later – the vicarious liability of the resort and their defence of contributory negligence.

Negligence is omitting to do something that a reasonable person would do, or doing something that a prudent and reasonable person would not do, to prevent harm. It is the failure to exercise reasonable care and skill that results in unreasonable risk of foreseeable injury.

In a negligence action you, as the plaintiff, have the onus of proof to establish 3 elements – duty of care, breach of that duty and causation (damage caused by the defendant). If any of those elements cannot established in your favour, no action. So begin with the duty question.

In this case, as the plaintiff, you must first establish that the defendant owes you a duty of care (here the focus is on the foreseeability of causing harm to you as the plaintiff.) This is essentially a question of law that the judge decides based on common law principles. To establish a 'duty of care', you as the plaintiff, must show that the kind of harm you suffered was reasonably foreseeable and was a result of the act/s or omission/s of the defendant. One way you can do this is by showing that you were one of the class of people who would foreseeably be at risk of injury if the defendant failed to take reasonable care. Duty will only be imposed when it is reasonable in all the circumstances to do so.

From the facts we are told that the lifeguards on duty could see the sandbars and should have been aware that diving into the water without checking its depth was dangerous. The lifeguards sole purpose was to ensure the safety of swimmers and they owed them a duty of care to ensure that the flags were properly place so as not to endanger their safety. They failed to do this and so have satisfied the first element for a negligence action. You would argue that this type of accident can be said to be well established because the facts fall into a well-recognised duty category involving dangerous beach conditions.

Who would you sue? From the facts were are told that the resort employed the lifeguards. That makes the lifeguards employees of the resort and at the time of the accident we are told they were on duty. Now, who do you sue? It is highly unlikely the lifeguards would have nay money to pay the amount of damages you would be seeking, so don't bother. However, as the lifeguards were on duty at the time of the accident, it would be possible to sue the resort under a principle called vicarious liability. That is where an employer can be held liable for the actions of their employees. More on this later in the chapter.

The resort will argue that they have a defence called contributory negligence. This is a defence where they will argue that a beachgoer would understand that diving into the water first without checking it was safe was negligent, that is, that a reasonable person would check the water depth before diving. You would argue that the purpose of the flags put into the sand by the lifesavers indicated to all swimmers that it was safe to do so.

What does the term 'reasonable person' mean to you?

Begin by defining what is a 'reasonable person' and then explain what the term means to you.

A reasonable person is a hypothetical person created by the courts who is of normal intelligence, credited with such perception of the surrounding circumstances and such knowledge of other pertinent matters as an average person would possess.

What factors does a court take into account when judging the standard of care under common law?

Begin by explaining what the term 'standard of care' means and then explain the factors that a court takes into account when judging the standard of care.

The standard of care is the level (standard) that the defendant's conduct is measured against objectively. It is a question of law, not fact. The question to consider is: What would the reasonable person have done if they had been in the defendant's position?

It will vary from situation to situation, and is flexible depending on the circumstances of the case—for example, is it an emergency?—as well as the personal characteristics of the defendant, including age (young children are not expected to exercise the same degree of care as adults), fitness, health, disability, skill, and knowledge. In the case of children, the reasonable person test gives way to a different standard, that is, the standard of a child of similar age and experience.

Do you think children should be treated differently to adults?

A personal opinion question. What do you think? Should children be treated differently to adults?

In the case of children, you need to understand that they are less capable than adults in taking care of themselves. So the reasonable person test gives way a different standard, that is, the standard of a child of similar age and experience**.**

If you are placed in a position of responsibility for children, directly or indirectly, you must make the children's safety your foremost concern. This carries a more onerous duty of care because children don't perceive danger or risk in the same way you do as an adult. There is a duty of care placed on you but your obligation is to exercise reasonable care, not a duty to prevent conduct that could be potentially harmful.

Problem answer

Another problem question and while it is a negligence question, this time you are looking at the question of causation, so begin by explaining what causation is and then look at the facts again and consider whether the driver should still have to bear the consequences for your injury.

Remember that in a negligence action you, as the plaintiff, have to establish three elements – duty, breach and damage. Drivers of vehicles owe a duty of care to their passengers and other road users to exercise care at all times whilst driving. So the first step is satisfied. There has been an accident and so the driver has breached their duty of care. But is the driver responsible for heroin addiction?

The answer to the third question, that of causation, is that on the balance of probabilities the answer is probably no. Causation is determined subjectively—that is, what the injured person would have done, in the light of all relevant circumstances—as distinct from the objective test of the conduct of a reasonable person. In this case, an intervening events involving the actions of a third party giving you heroin to ease the pain, responsibility for the harm, that is, the heroin addiction, should not be imposed on the driver.

Can you explain the purpose of causation in relation to the liability of a defendant.

The question is only asking you to explain the purpose of causation, so define it.

Without causation, a defendant cannot be held financially liable for damages. The plaintiff not only has to prove that the defendant owed them a duty of care and they breached that duty, but also that the breach of duty caused the damage that led to the injury.

Having established duty, breach and damage, do you think the defendant should be liable for all the damage have suffered?

An opinion question, so not necessarily a right or wrong answer. Explain the purpose of causation and then whether you think it is fair or unfair that a defendant has to

pay the plaintiff's claim for the occurrence of a physical injury which the plaintiff was prepared to accept?

It only seems fair that a defendant should only be liable for the damage that was foreseeable and which was attributable to that which made their act wrongful. Why should a plaintiff be compensated for the occurrence of a physical injury when he was prepared to accept the risk?

Problem answer

This is a vicarious liability question. Begin by explaining why you probably would not sue the barmaid and why you would look to trying to sue the employer on the basis of vicarious liability. So explain what vicarious liability is, what has to be proved (the elements) and whether you think you could win.

The barmaid is unlikely to have any money to pay for damages and legal costs, so vicarious liability seems to be the only choice. This is where an employer can be held vicariously liable for the acts or omissions of their employees who cause injury to a third party. The barmaid was working at the time and that involved serving drinks to customers, so her actions in serving the customer were in the course of her employment. However, by her actions then of throwing the beer over you and followed by the glass were not what a reasonable person would do. Vicarious liability is a sub-set of negligence and having established that she was acting the course of her employment, discuss the four elements of negligence – duty of care (of a barmaid), breach of duty (when barmaid throws contents of glass and then the glass in your face), damage to your face ('but for test' and factual causation), and damages (or compensation). Do the employer or the barmaid as the defendant, have a defence such a contributory negligence?

Problem answer

Another problem question. Note from the facts where the injury to the mother occurred and how it occurred. It was on a property she was at where there was a garage sale (not a commercial market) and there was an uneven surface on the drive, a typical of houses in the area,. And she was distracted by the goods on display. This is a question then about the responsibility of the owner of the house as the occupier.

In this case the *Wrongs (Miscellaneous Provisions) Act 1975*, Part XII s 52 have replaced the common law relating to the liability of occupiers for damages that are suffered on premises. An occupier under the *Wrongs (Miscellaneous Provisions) Act 1975* owes the same duty as they would have in common law, that is, to exercise a duty of care to all

visitors that are reasonable as in all the circumstances, so that it will be reasonably safe in coming on to the premises to view the goods on sale.

In this case, would a reasonable person in your position as the occupier have seen that there was a real risk to the mother as an uneven surface was atypical for that area? What would a reasonable person have done in response to the risk? Was the risk obvious? Should the mother have been more careful as she would have been aware of the risk? Put up a sign maybe? Remember, what you are looking at is what is reasonable in the circumstances.

If this was a commercial market, then there would be a much higher duty of care. Can you see why?

Problem answer

Another problem question where you need to read the facts carefully. It concerns the liability of a manufacturer of defective goods, so that should tell you this is about product liability and negligence. So explain what product liability is and what needs to be established to win the case. (It could also involve the Goods Act and fitness for purpose and merchantable quality but that is week 6)

Manufacturers owe a duty to the consumer to take reasonable care when:

- a product is sold, that it reaches you as ultimate consumer in the form in which it left the manufacturer; and
- there is no reasonable possibility of intermediate examination by you; and
- it is reasonably foreseeable that, in the absence of reasonable care by the manufacturer, you will be injured.

If a product is negligently manufactured, assuming it is locally manufactured, that company or business is responsible for how the product is made. As the case of *Donoghue v Stevenson* illustrates, the manufacturer owes a duty of care to the consumer to take reasonable care as absence of reasonable care in the manufacture of the product can result in injury to you as the consumer, and liability common law for the manufacturer in negligence.

Problem answer

The last problem question in this chapter. Here the facts tell you that there has been an escape of water that has flooded the neighbour's mine caused by the negligence of some independent contractors who were constructing a reservoir on

the defendant's property. The defendant knew nothing about the old mine shafts. Should a person be held strictly liable? So begin with an explanation of strict liability and then outline the elements that need to be satisfied and apply to the facts.

From the facts it would seem that the only cause of action available to you is strict liability, or the rule in *Rylands v Fletcher.* In such a case the defendant is responsible for damages that result from their act, whether they were negligent or not. It is a cause of action that can arise if an occupier of land (the defendant) accumulates or brings on to their land something which could be 'dangerous' if it escapes in the course of some 'non-natural' use of their land to a place outside their occupation or control. They must keep it in at their peril, and if they don't, they are strictly liable for all the damage which is deemed to be reasonably foreseeable.

To have a cause of action in strict liability, you must be able to establish that:

- that the defendant brought something onto their land (a reservoir to store water);
- that what the defendant made a 'non-natural use' of the land (the defendant was having a reservoir built to store water which is not a natural use of the land);
- that what the defendant brought onto the land was likely to do mischief if it escaped (where the water escaped on to your land, that is, you mine); and
- that there was an escape from the defendant's land over which the defendant had control or occupation to a place over which he had no control or occupation on to your land which caused damage of a reasonably foreseeable kind.

Chapter 4

What elements are necessary for the creation of a valid simple contract?

Agreement (consisting of offer & acceptance) plus Intention to Create Legal Relations plus Consideration = Contract

Explain the difference between a formal and a simple contract.

Just note that the difference between this question and the one above is that this question asks you to 'Explain' and so you are going to have to write a more detailed answer. The first question is asking you to list the elements, nothing more.

Essentially, the difference between a formal and simple contract is consideration. A formal contract is signed, sealed and delivered, and derives its validity from its form alone (it does not need consideration). A simple contract requires the presence of all six elements (including consideration) and compliance with any statutory requirements (form), and may be oral, written, or partly oral and partly written.

Explain what sort of problems may arise in contract law for users of e-commerce? Discuss.

Begin with an explanation of what you think an e-commerce is. Then you can go on and list what you see are problems using e-commerce.

E-commerce, or electronic commerce, is about the buying and selling of goods and services, and the transmission of money and data, over the internet.

While there are a number of advantages of e-commerce, we are being asked to consider what are the disadvantages. While you may think of more, here are some:

- Online identity identification – is the visitor to a site who signs up, a legitimate customer?
- Limited face-to-face interaction – customers can't try before they buy and this can lead to buying indecisions and refunds.
- Product return and refund
- Technical challenges – this can include technical glitches such as software failure, website crashes.
- Data security concerns – cybersecurity attacks and spam are the biggest e-commerce challenge. E-commerce websites often store customers' card information to allow faster purchases in the future, so if a site is hacked, the hackers can acquire personnel information on you. Customer data is compromised, and the web sites of affected businesses lose sales from a damaged reputation.

Explain whether an unaddressed proposal in an electronic communication to create a contract is an invitation to make an offer or is it an offer that others can accept?

Note that the question says 'Discuss'. Explain what invitation to treat is.

The *Electronic Transaction Act 2018* applies to any kind of data message and electronic document in the context of commercial and non-commercial activities. Section 19(2) of the *Electronic Transaction Act 2018* provides that where the proposal is not addressed to one or more specific parties, but is generally accessible to parties online, it is to be treated as

an invitation to treat, that is, a party who receives an invitation to treat can make an offer to enter into an agreement which anyone who receives it can do. They are not binding.

Problem answers

A problem question. Just note what you are being asked to do, that is, comment on whether there is a contract based on an exchange of texts.

The exchange of texts is sufficient to constitute a note or memorandum to allow the court to draw the conclusion that the documents are connected and intended to create a contract as long as they contain the names of the parties, the subject matter and terms of the agreement.

Chapter 5

What problems, if any, can you see for consumers with the use of standard form contracts?

Begin by explaining what a standard form contract is and then look at potential problems with the use of standard form contracts. Remember that if you sign or initial the contract, you are going to be bound by the fine print, whether you have read it or not.

Standard form contracts are a commonly used and cost-effective option when conducting business, as they avoid the transaction costs associated with negotiated contracts. They are pre-prepared contracts where most of the terms are standard terms and conditions issued on a repetitive basis to multiple people, set in advance with little or no negotiation occurring between the parties and blank spaces for filling in names, dates and signatures. Standard form contracts can be found everywhere including airline travel, terms and conditions governing electricity and gas service, gym membership, online service contracts, catching a bus, furniture and electrical retailers, and so on.

Problems for consumers (and even small businesses) are that they often lack the resources and bargaining power to effectively review and negotiate terms in standard form contracts, that is, you get them on a 'take it or leave it' basis. These types of contracts contain a lot of legal 'fine print' that you as a consumer might not understand, you are often not given time to read it anyway, and if you ask a salesperson what it means you are often told not to worry. Standard form contracts also tend to be one-sided and benefit only the party who

prepared the contract because they will want to shift as much of the risk with the contract onto you.

What does the term 'agreement' mean to you? How often do you think you enter into an agreement and what it means legally?

Begin by explaining what the term 'agreement' means and then think about how often do you enter into an agreement and then comment on what you think it means legally.

An agreement should not be confused with a contract. While a contract is based on an agreement, not all agreements are going to become legally binding, enforceable contracts. While both a contract and an agreement involve a meeting of the minds and an exchange of promises, a contract is a more formalised agreement and, unlike an agreement, comes with legal consequences and enforceable rights and obligations. An agreement is much more informal and doesn't come with legal consequences.

An agreement is the first requirement for a valid contract. It is usually broken down into two parts: an offer by one party and an acceptance by another party (or parties) and while there is 'a meeting of minds', an agreement generally lacks definitive elements like intention and consideration that together make an agreement a contract.

How often do you enter into an agreement? For most people, including yourself, it would be several times a day unless you never leave home, go online, answer the phone, or answer the door to a stranger. But if you are an average person, then catching a bus to get to Uni, buying lunch, just spending money on something, or promising a friend after class would all constitute agreements.

Problem answer

A problem question. Just note that there are two parts to the question – could you win? And did the Supreme Court have jurisdiction (or the power to hear the matter)?

What do you think the effect of the CAS arbitration agreement between the parties was? Is there evidence of intention to enter into a contract from the conduct of the parties with each athlete promising, in favour of the others, to abide by the rules, among other things, to the selection process?

Because there was an exclusion clause contained in the documents, the Supreme Court would not have jurisdiction to hear the matter, and the appellant's appeal would be

dismissed. So, you wouldn't win. It is worth noting that several interlocking documents may be evidence of or constitute a multipartite contract.

Who were the parties (the plaintiff and defendant)?

The Plaintiff was Mrs Carlill and the defendant was the Carbolic Smoke Ball` Company

Briefly summarise the facts

The facts briefly were that the Carbolic Smoke Company had placed an advertisement in a newspaper for their products, stating that any person who purchased and used their product but still contracted influenza despite following the instructions would be entitled to a 100 pound reward. The company claimed that they had deposited 1,000 pounds in their bank to meet any claims. Mrs Carlill saw one of these advertisements and bought the product. However, despite using it properly, she still caught the flu. The defendant comapny refused to pay the money promised in the advertisement claiming it was an invitation to treat.

What were the issues before the court?

The main issue before the court was whether the advertisement was an offer or an invitation to treat.

Why did the court find the advertising could be construed as an offer?

The Court of Appeal found for Mrs Carlill, finding that the advertisement amounted to a unilateral offer by the defendant company. In complying with the conditions stipulated in the advertisement, Mrs Carlill had accepted the offer. The Court also found that a reasonable person reading the wording of the advertisement, and who acted in accordance with the terms, would think that the company intended to be legally bound; an offer could indeed be made to the world; wording need only be reasonably clear to imply terms rather than entirely clear; and consideration was identifiable in the use of the smoke balls.

Just as a matter of interest, would you sue if you had bought a product that the seller guaranteed would work and it didn't?

Well, what do you think? There is no right or wrong answer. This is just asking for your opinion but briefly explain why.

Explain what an offer is

The following are straightforward questions, but just note what they are asking. Is it to explain, discuss or nothing? Don't ever just say 'Yes' or 'No' but always give an explanation for saying 'Yes' or 'No'. Does it ask for an example? Or are there parts that you have to answer. So it is important to carefully read the question.

An offer is a clear expression of the terms under which a person is prepared to enter into a contract with another person and be bound by their acceptance of those terms.

What makes a statement an offer depends on what the parties had in mind (that is, the intention of the parties, which is considered in the next section) at the time the statement was made. In many disputes this will be impossible to determine, so the courts will rely on an 'objective test of a reasonable person'. That is, would a reasonable person have thought that the offer was made with the intention of the person making it being bound as soon as it was accepted by the person to whom it was addressed?

List and explain the main rules relating to an offer

Just note with this question there are two things you need to do: list the main rules relating to an offer and explain them as you write them down.

In determining whether there is a valid offer or something else (for example, invitation to treat, inquiry, or supply of information which cannot be accepted), there must be:

- an intention or willingness to be bound;
- a firm promise; **and**
- communication of the offer (preferably in writing if the transaction is important to the parties, though it can be oral or by conduct and by the offeror or a person authorised to make the offer or communicate it (that is, an agent of the offeror).

The following rules apply to offers generally:

- They may be made to one person, a group, or to the world at large.
- They may be kept open if supported by consideration.
- All terms must be brought to the notice of the offeree and followed exactly.
- An offer can be terminated or revoked before acceptance as long as there is not an option to keep the offer open for a certain period of time.
- A counter-offer or rejection terminates an offer.
- Lapse of time if the offeror specifies how long the offer will remain open.
- Death of either party if it is for personal services.

- Failure of a condition, that is, a condition precedent or subsequent.

Explain what is required for an offer to be validly accepted.

Here is a list of what is required for an offer to be validly accepted but you would need to explain each.

If there is to be agreement, the acceptance:

- must be made in reliance on the offer
- must be strictly in accordance with the terms of the offer
- must be communicated to the offeror orally, in writing or by conduct
- cannot be a cross-offer
- can be accepted only by the party to whom the offer was made
- must be absolute and unqualified; **and**
- once made, cannot be revoked without the assent of the offeror.

Explain why it is necessary to distinguish between an offer and an invitation to treat from the perspective of both a customer and a seller.

Here is a question where you need to read carefully because there are two parts to it. You have to comment on why it is necessary to distinguish between an offer and acceptance from the perspective of a customer and a seller. So, begin by explaining what is an offer and then what is an invitation to treat. Then look at how a customer and seller view them.

An invitation to treat is not an offer and, unlike an offer, cannot be accepted. It is only an expression of a willingness to start the offer and acceptance process, which in time may produce an offer and acceptance, but the party making an invitation to treat never intends to be bound. An offer, on the other hand, is a clear expression of the terms under which a person is prepared to enter into a contract with another person and be bound by their acceptance of those terms. What makes a statement an offer depends on what the parties had in mind (that is, the intention of the parties, which is considered in the next section) at the time the statement was made.

Now comment on how you think a customer and seller view an offer and invitation to treat. Perhaps they don’t think about it but what do you think?

Under what circumstances will an apparent invitation to treat situation become an offer?

In this question note the word 'circumstances'. It is plural, so don't think you only need to mention one circumstance.

If it is clear in the circumstances that a party intends their words or conduct to constitute an offer, then the courts will be prepared to construe it as such. An example of where an advertisement was considered to be an offer rather than one inviting offers (called 'an invitation to treat') was *Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256, where the court found that the words used in the company's advertising were sufficiently specific to show to a reasonable person that it intended to be bound. Similarly, the use of words such as 'rain check' or phrases such as 'until stocks run out' or 'one per customer' suggests that the offeror intended the offer to be promissory rather than a calling for offers.

Just note that it is important to look carefully at the words and/or conduct of the party making the offer (the offeror) to determine whether they are promissory or not, in order to see whether they could amount to an offer. Is there an intention or willingness to be bound?

Explain under what circumstances an offer can be terminated.

Again, the question uses the plural 'circumstances', and the word 'explain'. So, two points to note. As in the last question, don't think you only need to mention one circumstance BUT in addition, this time you have to explain what each circumstance is.

The circumstances under which an offer can be terminated include:

- Revocation – withdrawal of the offer by the offeror before the offeree's acceptance.
- Rejection or counter-offer – where the offer is rejected by the offeree's words, conduct or a counter-offer.
- Lapse of time – where the offeror has specified a time during which the offer will remain open. If no time limit is specified, then the offer will remain open for a reasonable time and this depends to some extent on the life span of the goods, that is, how long will they last?
- Death by either party – If the offeree learns of your death (and you are the offeror) before acceptance of the offer, then a purported acceptance will be ineffective because the offer will have lapsed. But where the offeree is unaware of your death, it is possible that a valid acceptance can still bind your estate if the offer does not involve the personal involvement of the deceased offeror.
- Lapse by failure of a condition – the offer could be subject to a condition, a condition

precedent or a condition subsequent.

Explain the difference between a condition precedent and a condition subsequent and give an example of each in relation to the purchase of a car.

Just note that the question is not only asking you to explain what conditions precedent and subsequent are but also to give an example of each.

A condition precedent is a clause or term in the agreement stating that a term in the agreement must first be satisfied for a contract to come into existence. For example, a 'I will buy the car subject to finance' clause in an agreement, if not fulfilled, causes the offer to lapse.

A condition subsequent clause, on the other hand, is a term in the contract that may cause the contract to terminate if the parties have stated that the occurrence of a particular event will give the parties that right. For example, I will return the car in 7 days if fuel consumption exceeds 15lt per 100kms.

Just note that the essential difference between the condition precedent and the condition subsequent is that in the latter the contract is already in operation.

Does acceptance have to be made strictly in accordance with the terms of the offer?

Here is a question where you can start with a 'Yes' or 'No' and then explain why.

An acceptance converts the promise or promises of the offeror (represented by the offer) into an agreement. Before acceptance of the offer, neither party is bound to the agreement; after acceptance. The effect of acceptance is that the offeree agrees to take exactly what is offered and to pay the price required.

Can anyone accept an offer even if it is not made to them?

Note here that the key word is 'not'. As in the last question, you can start your answer with a 'Yes' or 'No' and then explain why.

No. Only the person or persons to whom the offer was directed, or their authorised agent, can accept the offer. If someone else tries to accept the offer, that 'acceptance' is probably only at best an offer itself, which the original offeror, who is now the offeree, can accept or

reject as they wish. Where the offer is made to the world at large, acceptance is by those members of the public who perform the conditions set out in the offer.

Can silence ever amount to acceptance?

This question could be answered with a 'Yes' or 'No' but don't fall for that trap. Give an explanation. You could begin your answer with a statement that generally acceptance must be communicated to the offeror but there are situations where silence can amount to acceptance and then explain what they are.

There are situations where silence can amount to acceptance and they include:

- where the offeree has signed an agreement indicating continuing acceptance of delivery until further notification—for example, subscriptions to internet services or membership of a local gym debited on a monthly basis, where the offeree, by their conduct, has allowed work to go ahead and made progress payments and where you dispense with the requirement of communication, and acceptance is to be by performance of an act;
- where there is a history of prior dealings between the parties;
- where it is just and equitable – for example, where the conduct of the proposed tenant led the owner to believe that the tenant would lease the premises and the owner went ahead and undertook major demolition and construction work in that belief;
- by conduct, where the parties by their actions show that they intend to be bound; and
- where the postal rule applies

The ultimate issue is whether a reasonable bystander would regard the conduct of the offeree, including their silence, as suggesting to the offeror that the offer has been accepted.

Could an offer sent by email be accepted by letter if the offeror had not specified a particular method of acceptance? Give reasons.

Just note here that you need to give reasons for your answer. It really means the same as 'Explain'.

The answer is 'probably' because to some extent it is going to depend on what the offer was. If it was something perishable or goods in a volatile market, it can be implied that the offeror would have intended that acceptance be in the same mode or quicker than the way the offer was delivered. If the item was not perishable or it was clear to a reasonable

person that a fast reply was not of the essence, then acceptance by mail would probably be acceptable.

Explain why the rules on acceptance should differ between contracts by post and contracts by instantaneous communication such as email.

The difference lies partly in technology. Contracts by post have been overtaken by instantaneous communications and it has impacted on when agreement may be reached. Where the parties contemplate the use of the post as a medium of exchange of promises, the offeror must have contemplated and intended that the offer be accepted by the act of posting, in which case the rules as to the time of acceptance change. Thus:

- an offer made by letter is not effective until it is received by the offeree; and
- acceptance is effective as soon as it is posted.

But postal acceptance is much slower as a contract is formed when the letter goes in the post box. The fact that the offeror is not aware of the posting of the letter, or even if the letter is lost in the post, or is wrongly addressed to the offeree or is even never delivered does not matter. The post office is the agent of the offeror (unless the offeror states otherwise) and this means that communication to the post office is communication to the offeror but the offeror will not know whether the offer has been accepted until it arrives in his letter box some days after it was posted by the offeree. By posting the acceptance, the offeree has done all that is required of them and even if time is of the essence, it could take days for the acceptance to reach the offeror.

The main reason for different rules between acceptance by post and instantaneous communication or e-commerce is the benefit of speed of acceptance. The time of receipt of the electronic communication is the time when the electronic communication is capable of being retrieved by the addressee or, if no system is designated, when the electronic communication comes to the attention of the addressee. In other words, almost instantaneously.

How can businesses that make offers over the internet protect themselves from the risk of loss associated with the rules of offer and acceptance?

Just make sure that you discuss offers over the net and not offers generally.

To minimise problems with contract formation where the method of transaction is email or the internet, the person controlling the transaction should make it clear:

- what is to be taken as an offer or what is required for an acceptance
- when electronic communications are to take effect from, for example, when subscriptions are to end, as well as
- specifying that property in the goods will not transfer to the buyer until payment has been processed.

Problem answer

Another problem question. What is important here is what time did the acceptance take place? In addition, you need to comment on whether La Forrest accepted the offer and whether it was possible to have an acceptance by email to create contractual relations. So, if you are smart you will refer to the Electronic Transaction in your answer.

Yes, acceptance had taken place and La Forrest would be bound. An acceptance by email was capable of creating legal relations under the *Electronic Transactions Act 2021*, and in this case the parties had reached a binding agreement. While the Electronic Transactions Act provides times for receipt and dispatch, there was not a clear indication of the time at which the contract was formed. An acceptance by email was capable of creating legal relations under the *Electronic Transaction Act 2021*, and in this case the parties had reached a binding agreement. Formation of the contract occurred when the offeror received the offeree's acceptance at the server they had stipulated. This was either when the electronic message entered the designated information system because the offeror has designated their email address; or the place where the addressee had their place of business.

It is also worth noting that a series of emails together are capable of creating legal relations as they embody all the terms that are legally necessary to form a contract.

Chapter 6

Must intention to create legal relations be present in every contract?

Even though it appears the questions could be answered with a simple 'Yes' or 'No', still explain why you answer 'Yes' or 'No'.

The fact that the parties have reached an agreement is only the start of determining whether there is a contract. The next step in determining whether there is a contract is what the parties intended. Did the parties must intend to create legal relations? This can be **express** (words, writing or conduct) or **implied;** but if **it is not present, there can be no contract.** It must be present in every simple contract.

Most commercial agreements inherently possess this intention. However, it can be difficult to establish in domestic or social agreements. The courts will check to see if the parties meant to make a legal contract by looking at their objective intention.

How can you tell whether an advertisement is an offer or an invitation to treat? Explain.

Begin by explaining what an offer and invitation to treat are. Then explain how you tell the difference.

Intention can be determined by considering the relevant context and the relationship between the parties, and determining what inferences can be drawn from that; that is, by judging the parties on what they had said, written or done as well as taking into 'account the subject matter of the agreement, the status of the parties, their relationship to one another and other surrounding circumstances**'.** The parties rarely make any direct or express reference to the question of intention to contract within the contract itself. Where references are made, they are generally found only in commercial (or business) agreements and are invariably expressed in a negative way; that is, by way of terms that expressly and clearly state that the parties **don't** intend to be legally bound.

Why do you think that in most agreements of a commercial nature the law assumes that the parties intend to create legal relations?

Begin with an explanation of what an intention to create legal relations means. Then go on and explain why there is a presumption of an intention to create legal relations in a commercial arrangement.

Intention to create legal relations is defined as an intention to enter a legally binding

agreement or contract. In social or domestic agreements, the parties do not usually contemplate legal relations because if one party fails to honour their promise, the consequences are not usually financially significant.

In business or commercial arrangements where the relationship is not personal and is based on a business or commercial transaction, it is presumed that the parties intend to create legal relations. This is generally because of the financial consequences involved in doing business together. Each party involved in the contract is accepting the terms and providing consideration with the intention for the contract to be enforceable by the law. It gives the parties an element of certainty for the parties to the contract that in the event of a breach, there will be legal consequences. In determining if there is intent, the courts take an objective approach.

Is it possible to avoid creating legal relations in a commercial/ business agreement? Explain.

While it would be easy to just say 'Yes', don't. The question asks you to 'Discuss', so that means writing an answer to support 'Yes'.

The parties can negotiate on the principal terms of a proposed business or commercial transaction but intend to enter into a formal contractual document at a later date. In such a case, even though there may be offer and acceptance, the parties may make their agreement 'subject to contract' or 'subject to preparation of a formal contract', thus avoiding creating legal relations until the execution of a formal agreement.

The parties to a commercial agreement may also avoid a binding agreement by including an "Honour clause", indicating that the agreement is binding in honour only and not legally binding.

Why aren't voluntary agreements contracts? Explain.

Quite simply, there is no evidence of an intention to create legal relations by the parties in the agreement. Where there is an agreement, it is usually clear from the surrounding circumstances that a contract was not intended at the time of entering into the agreement. There is a lack of mutual intention to create a legally binding agreement. Compare this with a commercial situation where a reasonable person looking objectively at the facts would conclude that the parties would have intended an intention to create legal relations.

Can you list any agreements that you could enter into daily that could result in an inference that contractual relations were not

intended?

Up to you to answer this one. The question is asking you to list any agreements that you could enter into daily.

Why do you think that in most agreements of a voluntary nature the law assumes that the parties do not intend to create legal relations?

Begin by explaining what a voluntary agreement is, and then why the law assumes that the parties do not intend to create legal relations.

A voluntary agreement can be defined as an agreement where the parties normally do not intend to create legal relations. While there might be an agreement between the parties, it is usually clear from the surrounding circumstances that the parties did not intend at the time of entering into the agreement to create a contract, for example, where the work of one party was voluntary and they did not want payment for their services. Judged objectively, a reasonable person would conclude that the agreement was a voluntary one, and that the parties did not intend to create relations, so no contract.

Is it possible to create legally binding agreement out of a social or family relationship? Explain why.

While you could answer this as 'Yes' or 'No', just note the question is asking you to 'Discuss' so you need to add your reasons why you said 'Yes' or 'No'.

It is presumed that the parties in a social or family relationship do not intend to create legal relations, even though the agreements may have contained promises made by the parties. In these cases the court objectively determines whether the parties intended to create legal relations. If no such intention exists, the agreement will be no more than an unenforceable promise. This is because it is generally unusual for an arrangement between family members or social outings to be thought of in terms of legal consequences if something goes wrong, for example, you agree to go to the movies with a friend and your friend forgets to turn-up, are you going to sue them?

Agreements made in family or social relationships can sometimes be legally binding. It depends on the merits of each case and to determine whether there is the required intention, the plaintiff has to produce evidence to show that a contract was intended. The court will then look at the conduct of the parties and decide whether a reasonable person, in the same position as the plaintiff, would have intended to create an enforceable contract. If the consequences for the plaintiff were serious, then the plaintiff will probably succeed

in their claim. However, if you are considering suing your friend for not turning up at the movies, forget it.

Agreements made in a domestic relationship are considered unenforceable, for example, agreements made while the husband and wife still live together or in a continuing de facto relationship, it is assumed that the parties don't intend to create legal relations. However, if the parties are separated at the time of the agreement, then the agreement will be enforceable.

In the agreements that you enter into, do you consider the question of intention? Explain why.

While you could answer this as 'Yes' or 'No', just note the question is asking you to 'Discuss', but also note that this time the question is focussing on whether you think about the question of intention when entering into an agreement.

Chapter 7

Should consideration still be an essential element in a contract today? What does it achieve?

Begin with an explanation of what consideration is and then explain whether you think it should still be considered an essential element.

Explain the distinction between executed, executory and past consideration.

Define each of the terms and to you should have answered the question.

Executed or present consideration is where an act is done in return for a promise.

Executory or future consideration is where the **parties exchange promises,** each promise being consideration for the other. In this type of situation, consideration is intended to be performed in the future**.**

Past consideration (or past performance) is where the promise is given after an act has been performed and is generally not enforceable.

Why don't formal contracts, such as deeds, require consideration?

Begin by explaining what a formal contract is and then explain why consideration is not needed.

A formal contract is a written agreement between two or more parties that outlines the terms of their relationship and is legally binding. A deed is a written agreement that confirms an agreement

between parties which does not require consideration, but must be signed, sealed and delivered. It must state that there is an intention to be a deed. It derives its validity from itsform alone.

Why is past consideration no consideration?

Note the question is asking you what is past consideration, so define it and explain why it is no consideration. A good question to answer with an example after your definition.

Past consideration (or past performance) is where the promise is given after an act has been performed and is generally not enforceable. Let's say you agree to clean your friend's car. After you have finished he says, "Great job! I'll pay you K$50." Is there a contract? Your ex-friend does not have a contractual obligation to pay you because your act occurred in the past. It was never agreed that you should clean your friend's car. They might be grateful and could feel a moral obligation towards you but there is no contract. To have legal consideration the parties must reach an agreement prior to cleaning as to what each party will give and what each party will get.

Why is repeating an existing duty not good consideration

Repeating an existing duty owed to the promisor is insufficient consideration because there is no detriment. If you are already contractually bound to the promisor to complete a task, the general rule is that in performing that task you are doing no more than you contractually agreed to do. However, acts in excess of your duty would amount to good consideration to support a new contract

Problem answer

Another problem question. The questions is about forbearance to sue, so begin by explaining what it is and then whether it can be used here. Interestingly, the claim is probably bad in law but that will not matter.

Forebearance to sue can amount to good consideration. It is good consideration even if the promise is to forbear only for a limited period or to dispense A promise not to enforce a valid claim and/or a promise to give up a claim entirely can be good consideration for a promise given in return. with a doubtful, but reasonable, legal claim. The claim that is promised to be relinquished must be:

- honestly held (there must be a genuine dispute); and
- one in which the claimant has a bona fide belief that the liability is real at the time of agreement.

In this case there appears to be a genuine dispute between the parties as to their respective rights and obligations, and the agreement to repair the car was a compromise of that dispute. The compromise was good consideration for a new contract. If a party choose to compromise a claim, there must be a genuine dispute and the bargaining aspect of the agreement must be evident between both parties. It does not matter that the plaintiff may not actually have had an enforceable claim.

Chapter 8

Problem answer

A problem question concerning infants. Just remember that the law looks at beneficial contracts or service where infants are concerned as still being valid if they contain unfavourable terms. So begin by explaining what is a beneficial contract of service, then what the courts look at and apply to the facts above.

When looking at covenants in contracts of employment, look at the contract as a whole. In this case, even though the clause about not practising within 200kms of Port Moresby may be onerous, the contract taken as a whole is probably okay. As the original contract was for the defendant for education and employment, while it contained onerous terms, weighed against the benefits, looking at the contract as a whole it was for the benefit of infant.

Discuss how a court decides whether goods or services purchased by an infant will result in a valid contract.

Note the question is asking you how a court decides (not how you decide) whether goods or services are capable of being necessaries. Don’t comment on beneficial contracts of

service. So begin by defining necessaries, and then what the courts look at to establish if the goods or services are necessaries.

The definition of necessaries includes articles and services essential for the reasonable comfort of the infant, as well as basic food, medicine, education, clothing and shelter. This means that lifestyle and the infant's situation must be considered when trying to determine whether the goods or services are capable of being necessaries or not looking at the transaction as a whole. Are the goods capable of being necessaries and if they are, are the goods or services necessaries in the particular circumstances (a question of fact)?The court will also contract consider whether, on balance the contract is favourable for the infant, which means that the infant should only pay a reasonable price for the goods or services.

Samantha, an infant, obtained a loan of money from Lucy by telling her that she was 19 when in fact she was only 16. Samantha subsequently defaulted on the loan repayments and Lucy wants to know whether she can recover her money. Advise Lucy.

Ignore the criminal law issue here. As a rule of thumb, infants normally do not have the capacity to obtain a loan because they lack the ability to understand what they are getting themselves into and they can lack a capacity to repay.

As this appears to be an unsecured loan to Sam who has obtained a load for no known purpose, the contract would appear to be unenforceable and Lucy would be unable to recover the money.

Ryan, a 78 year old-alcoholic who, during a drinking session with Bromley, was induced to sell his farm to him for much less than its market value. A written contract was drawn up at the Bar and signed by both parties. Ryan later refused to go through with the sale.

Is the contract that Ryan signed enforceable by Bromley? Discuss.

Note that Ryan is a 78 year-old alcoholic, so the question here is whether Ryan would understand what he was signing.

Contracts with a mentally unsound or intoxicated person are usually regarded as being voidable at the option of, in this case, Ryan unless they are necessaries. From the facts, the sale of his farm would not be regarded by the courts as being something that fell within the ambit of necessaries. So where the goods are not necessaries, Ryan may be able to

repudiate the contract if and when he sobers up. The onus of proof is on Ryan and must occur within a reasonable time of him regaining sobriety or soundness of mind. In this case Bromley would have realised Ryan was seriously affected by alcohol and that his judgment would have been seriously affected as a result. The disability was present at the time of contracting.

Steinberg, a minor, applied for and was allotted shares in a company when she was 16. She received no dividends and attended no company meetings. Before she turned 18 she repudiated the contract and tried to recover the money she had paid for the shares. Can she? Discuss.

In this case, just note her age when Steinberg repudiated the contract and what the contract was about. Unlike question 2 above, in this case she has acquired an interest in subject matter of a permanent and continuous nature, that is, the purchase of shares.

This is a contract that is valid unless and until it is avoided, that is, it is voidable. When an infant repudiates a voidable contract during infancy, which in this case she did before she turned 18, the rights and liabilities that accrue after repudiation cease. This means that Steinberg will remain liable for any obligations accrued up to the time of repudiation of the contract unless there has been a total failure of consideration.

Money paid under a voidable contract is not able to be recovered unless the Steinberg has received no benefit from the contract what so ever; that is, there has been a total failure of consideration. In this case, while Steinberg could have her name removed from the company register and she could rescind the contract, she would not be able to recover the money she had paid for the shares. The allocation of the shares had conferred a benefit on her, so there was not a total failure of consideration.

Chapter 9

Problem answer

In this fact situation, you need to work out first what area of law may apply. Read the facts carefully and you should realise that there has been a mistake by the Commission as to the whereabouts of a tanker. What type of mistake? What are elements that need to be established to establish the mistake. Apply to the facts.

From the facts it appears that this would be a case of mistake as to the existence of subject matter. A common mistake must involve the existence or identity of the contract's subject matter. The Commission, by calling for tenders has impliedly promised that there is a tanker and that it can be located at Jourmaund Reef, leading you to believe that the tanker existed. On the strength of this promise you have successfully tendered for the salvage of the tanker, then you hired a ship, fitted it out and proceeded to the location given by the Commission and spent a month fruitlessly searching for a ship that didn't exist. The acceptance of the tender by the Commission created a contract which the Commission has broken by its failure to perform, that is, to provide a salvageable tanker. The Commission cannot now not accept its responsibilities.

Explain why money paid under a mistake of law may be recoverable while a party who makes a mistake wrongly interpreting a statute, or a mistake of judgment (for example, buying clothes and then not liking the style or colour) or a mistake as to quality, generally cannot rely on the mistake to avoid the contract.

Begin by explaining what a mistake is and that only mistakes of fact can render a contract void.

Only mistakes of fact can render a contract void. If one of the parties makes a mistake of law (for example, wrongly interpreting a statute), a mistake of judgment (for example, buying clothes and then not liking the style or colour), or a mistake as to quality, then that party generally cannot rely on the mistake to avoid the contract. 'Buyer beware'. However, money paid under a mistake of law may be recoverable if the money was paid by the payer under a mistaken belief that they were under a legal obligation to pay it or that the payee was legally entitled to payment of it and is recoverable from the payee (on the basis of restitution).

You were in London when you received an order from a Middle East agent for 'Moroccan horsebeans described here as feveroles'. Not knowing what the term meant, you asked the defendants, who replied that feveroles were the same as horsebeans, which they were in a position to supply. The plaintiffs then ordered a quantity of horsebeans from the defendants and the goods so described in the written sale document that was drawn up were delivered to the plaintiffs, who in turn shipped them to Egypt. When they reached Egypt, the plaintiffs refused to accept them since they were not feveroles. Had the plaintiffs any cause of

action against the defendants?

Another case of mistake. Read the facts again. The order was for 'feveroles', not 'Moroccan horsebeans' and the plaintiff was given the wrong information by the defendant. The buyer refused to accept delivery as they were not what they ordered.

This would appear to be a case of mutual mistake where the parties are talking about different things, so there is no real agreement between them. Each of the parties is unaware of the error and are mutually mistaken as to what the other party wants. In other words, the offer and acceptance are not the same, so the contract is *void ab initio*.

Buka has a very poor understanding of English. When you approached him with a document for his signature, Buka was under the honest and mistaken belief that what he was to sign was only a letter of introduction to his agent. What he in fact signed was a lease of his shop premises to you —which at no time did Buka intend or want to do. You are now suing for specific performance (to force him to give you his shop) and damages for breach of contract. Advise Buka.

In this fact situation, note that Buka has a poor understanding of English and doesn't understand what it is he is signing. A classic case of *non est factum* (it is not my deed). Begin by explaining what *non est factum* means and then apply your understanding of the term to the facts.

Non est factum (Latin for "it is not [my] deed") is a defence that allows a signing party such as Buka to escape performance of the agreement as it is fundamentally different from what he thought or intended to execute or sign, making the contract void.

Buka, as the signing party, would have to argue that the agreement was void because it was radically different from what he thought it was. To succeed in a plea of *non est factum*, two conditions must be met**:**

- Buka must believe that the document he signed was radically different from what he believed it to be—the mistake must go to the fundamental nature of the document and not its contents. From the facts, Buka thought he was signing a letter of introduction to his agent, not a lease of his shop; **and**
- there must be an absence of carelessness or negligence in the execution of the document. Buka appears to have signed the `document in good faith and did not understand it was for the lease of his shop because of his poor understanding of English.

Buka could successfully argue this was a case of *non est factum* and that you will not get either damages or an order of specific performance.

Explain why you would prefer to base a case on unilateral mistake rather than common mistake or mutual mistake, if there is a third party involved.

In this question, begin by explaining what unilateral, common and mutual mistake are and then which of the three mistakes is your preference if a third party was involved.

In the case of a common mistake, the parties acknowledge the existence of an agreement (for that is admitted) but, because of a fundamental assumption as to the existence or identity of the subject matter, they wish the court to set the agreement aside from the beginning. A common mistake that goes to the very root of the contract will potentially render the contract void ab initio (from the outset).

In the case of mutual mistake, as the parties are talking about different things, there is no real agreement between them**.** If the conflicting understanding is so severe that the courts cannot find an agreement, the contract is generally treated as void initio (from the outset).

In the case of unilateral mistake, there is a lack of agreement between the parties. However, here only one party to the contract knows, or ought to be reasonably aware, of the mistake and does nothing to correct it. The contract is usually voidable which means the innocent party, when they act, can rescind the contract or continue with the contract and hope it is okay (remember what voidable means).

So, what is your preference?

Is there a contract between you and Bruce? Explain why/why not. Do you think you have done enough to check on the identity of Bruce?

Read the whole situation and questions carefully and note that you are asked to do two things: consider whether there is a contract and then whether you did enough to check the ID of the person whom you dealt with. You are led to believe that the customer is someone else. Is this because of a mistake or a misrepresentation over identity? But only one party is mistaken, so this is a case of unilateral mistake. So, begin by explaining what unilateral mistake is and then what the situation is where the parties meet face-to-face.

This a case of unilateral mistake as you are led to believe by the customer that he is Bruce

Wayne, an MP. A unilateral mistake involves a lack of agreement between the parties. Here only one party knew of the mistake as he created it and was obviously not going to do anything about correcting it. A case of fraud but ignore the criminal law in this question.

Where the parties meet face-to-face, the onus is on you (because you are the plaintiff pleading the mistake of identity) and you are going to have to show that you intended only with Bruce and no-one else, that you never intended to deal with whoever the customer was, and that you took reasonable precautions to check the customer's details, and the customer knew you never intended to deal with anyone but Bruce.

If these points can be established the court will treat the contract as void. However, if the intention is to deal with the customer, whoever they might be, then the contract can only be treated as voidable. That would not be a problem if it was a two-party situation but here you have Brooks, a third party and a voidable contract. If the swindling customer can sell the goods before you realise you have been swindled and can rescind (remember it is a voidable contract and that means it is valid and binding until rescinded), a purchaser buys the jewellery for value in good faith gets good title and you are left with the problem of finding the swindler if you want to get your money back.

The question you need to consider here is whether you think you have done enough to establish that the customer was a fraudster and not Bruce?

The vendor of a farm that you are interested in buying told you that it had never been used to raise cattle but in his judgment the property would easily be capable of carrying 500 cattle. This proved to be untrue. Can you now avoid the contract? Explain how.

From the facts you have been given, this is probably a case of innocent misrepresentation. The vendor has told you the property had never been used to raise cattle but in his opinion it could carry up to 500 cattle. Think about the three possibilities for misrepresentation – fraudulent, innocent or negligent. Briefly explain each and then suggest which is likely to apply.

From the information given, it would appear to be a case of innocent misrepresentation. An innocent misrepresentation is a misstatement of a material fact, but made without intention to mislead, that is, in good faith by the farmer and not known by them to be false. You are told the farmer had never used the property to raise cattle but, in his judgment, thought it could easily carry 500 cattle. It can't be a fraudulent misrepresentation because the farmer's statement was not one of fact made knowingly to be untrue. Note he said he had never raised cattle but in his judgment thought it would carry 500 cattle. And probably not a

negligent misrepresentation, again because of the qualifications in the farmer's reply, that is, he has told you he never raised cattle and so his judgment is suspect because he has never raised cattle. This would alert a reasonable person to make further enquiries.

Eddie had a 2023 Toyota Prado Land Cruiser, which he wanted to sell. He advertised it for sale for K100,000. Eddie eventually sold it to Maria, who took it away, after giving him K90,000 cash. Unfortunately, the notes were forgeries and when he took the money to the bank the following morning, the bank refused to accept it and called the police. In the meantime, Maria sold the car through a firm of car dealers to Intergalactic Finance, who had no notice that Maria had acquired the car fraudulently. You bought the car in good faith and without notice of the defect in title. Do you have good title to it?

In this case, the facts tell you that this is more likely a question of unilateral mistake than fraudulent misrepresentation, so begin by explaining why it is not fraudulent misrepresentation and why unilateral mistake. Then explain what sort of title did Intergalactic get and then what sort of title do you get?

A representation is a statement of past or present fact made by one party either before or at the time of making the contract that induces the other party to enter into the contract. Fraudulent misrepresentation refers to a deliberate false statement made with the intention of inducing someone to enter a contract. The contract, as it is induced by fraud, is voidable at your option if you are the deceived party because it does not represent the parties' true agreement. The problem you have here from the facts is that it doesn't appear that Maria has made any false representations.

Is it a case of unilateral mistake then? In the case of a unilateral mistake one party to the contract knows, or ought to be reasonably aware, of the mistake and does nothing to correct it. Eddie has accepted the K90,000 under the mistaken belief that the notes were good currency and was not aware of a problem until he went to the bank the following day.

The importance of unilateral mistake is that it makes the contract *void ab initio* (void from the beginning). This means that a third party such as, in this case, Intergalactic Finance, cannot get good title to Toyota. This means they cannot pass on good title to you as they don't have a good title. Eddie still has ownership and can claim his car back from whoever has possession, which is you. You will have to get your money back from Intergalactic Finance as you bought the vehicle from them. They, in turn, have to find Maria, and try and recover their money from her.

What would you need to establish if you were the plaintiff in order to succeed in an action involving a negligent misrepresentation? Explain why.

Explain what a negligent misrepresentation is and what you need to establish a case in negligent misrepresentation.

Negligent misrepresentation lies in the tort of negligence, not contract. It arises when a person provides oral or written advice to another person in 'serious circumstances', knowing that the information or advice may be acted on, and fails to take reasonable care to ensure the accuracy of the information.

To succeed in an action for negligent misrepresentation, you have to establish that a 'special relationship' existed between you and the other party and that you relied on the representation, trusting the other party to exercise a duty of care in the giving of the information, realising that you intend to act on that advice or information, that it would be reasonable for you to rely on it and that you did suffering damage as a result.

Explain the meaning of the term 'duress' and distinguish it from 'undue influence'.

Explain duress and undue influence and then you should be able to explain the difference between the two actions.

Duress is the use of violence or illegal threats against a person, their goods or their economic interests to force them to enter into a contract against their will. The duress does not have to be the sole reason for the coerced party entering into the contract, it just has to be one of the reasons. The onus is on the party who has made the threat to show that it had no effect on the other party, and if they cannot do that, the contract is voidable at the option of the coerced party because there is a lack of voluntary agreement. In the case of economic duress, restitution and avoidance of the contract are the only options to a plaintiff. Damages are not available.

The difference between duress and undue influence is the latter has its origins in equity and involves the improper use of a position of influence or power possessed by one person over another in order to induce the latter to act for the former's benefit. The contract is voidable at the option of the innocent party, and the usual remedy is rescission.

Cases of undue influence fall into one of two classes. Briefly explain what the two classes are and give examples.

Begin by explaining what undue influence is and then explain what the two classes are.

It can exist in two types of situation: where there is a special relationship of trust and confidence between the parties such as parent and child and doctor and patient, but it can also exist where there is no special relationship but only if the weaker party is able to prove that the other party (the dominant party and the defendant) exerted influence over them, and thus obtained a contract that they would not otherwise have made, for example, where the plaintiff has little or education, or where one party occupies a position of dominance or influence over the other party. The contract is voidable at the option of the innocent party, and the usual remedy is rescission.

Allcare joined a religious order in 2019 aged 19 as a novice nun. In taking her vows of chastity, obedience and poverty she had to give away all her goods and money which she donated to the sisterhood. She left the sisterhood in 2024. Is Allcare entitled to get her goods and money back? Explain why.

In this fact situation, do you think there is a special relationship of trust and confidence between Allcare and the religious order? Is this an example of a special relationship of religious adviser and devotee involving undue influence? What do you think a religious adviser does? Was the transaction a voluntary one? Is the age of Allcare important? So begin by explaining what undue influence is and then what has to be established. Don't forget to say whether you think Allcare can get her goods back?

Undue influence, which is based in equity, involves the improper use of a position of influence or power possessed by one person (the dominant party) over another (the weaker party) in order to induce the latter to act for the former's benefit. The contract is then voidable at the option of the innocent party, and the usual remedy is rescission.

Is this a case where there is a special relationship between the parties though? From the facts it appears to be a case where it can be argued that a special relationship might be presumed to exist. Note the use of the word 'might'. Undue influence is presumed to exist in situations where there is a special relationship of trust and confidence between the parties such as religious adviser and devotee.

Are the roles of religious adviser and religious order sufficiently similar to create a special

relationship that the law might recognise as a special relationship for the purposes of undue influence? A religious order is akin to a spiritual family within the church, its members living by a specific set of rules and giving up what we might consider to be a 'normal life' like marriage and personal property which, in the case of the latter, Allcare gave up when she joined.

If we accept that this is a case where a special relationship can be presumed to exist, then the onus is on the sisterhood to prove that Allcare's giving up of all her money and property was a voluntary one and there was no undue influence exercised by the religious order. Given the Allcare was 19 at the time she made the decision to join a religious order, she would be considered to be an adult and there is a lack of evidence to show that the decision to join was anything but voluntary, Allcare would seem to have little chance of getting her goods or money back.

Problem question

In this fact situation you are given a head start in terms of what area you need to consider. Here begin by explaining whether you think improper influence and undue influence are. Do they have different meanings or are they one and the same. Or could both apply? Note the question also has two parts because you need to make sure you also explain who has the burden of proof.

Improper influence is a term used to describe a situation where a person exerts influence or pressure or influence an another in a way that is considered unfair or unethical and includes undue persuasion and nepotism. Undue influence, on the other hand, looks at the quality of the consent given to the contract, that is, did one party influence the other party so much that consent was not freely or voluntarily given? The two are closely related.

From the facts, this case appears to be more about undue influence where no special relationship existed, so it must be proved as a fact. Was there, before the transfer of the cottage, a relationship of trust and confidence between Buttress and Johnson, such that it could be said that the presumption of undue influence arose? Johnson was in a position where she had influence over Buttress. From the facts, the gift could be presumed to be the result of that influence and as a result Johnson would have to rebut the presumption that Buttress had not exercised his free will unhindered by her influence.

Just as a matter of interest, this was an actual case (*Johnson v Buttress* [1936] HCA 41), and the decision could have gone either way. There was a long standing friendship between Johnson and Buttress and during that time there many acts of kindness by Johnson, but it was not enough to rebut the factors that may constitute a special disadvantage in

establishing unconscionable conduct which in this case include his illiteracy, ignorance of what was happening, and his disposition which together suggested vulnerability.

Problem question

Another problem involving unconscionability but in this case about the bank manager's behaviour and whether it was unconscionable. Begin by explaining what you think unconscionable conduct means and then go on and apply it to the actions of the bank manager.

In its equitable jurisdiction the court may set aside a contract as unconscionable where there has been an abuse by the defendant bank of their superior bargaining position in their dealings with the Amadio's. Unconscionable conduct leading to an unconscionable contract involves questions of fact and degree, and each case must be judged on its facts. If the facts show that the conduct of the defendant was such that in its factual setting fairness and good faith could properly be expected to be exercised, and it can be shown that they were not, then the conduct of the defendant bank may be described as unconscionable.

Not every unfair contract is going to be set aside on the grounds of unconscionability. For a contract to be set aside on the grounds that it was unconscionable, the Amadio's must prove that:

- They were in a position of 'special disadvantage' at the time of the contract.
- It must have substantially affected their ability to protect themselves.
- The bank must have known, or should have known of the Amadio's 'special disability.'
- The bank manager had taken unfair advantage of it in such a way that the actions of the bank manager were unconscionable (that is, unfair or unjust).

There are two questions to think about. Was the conduct of the bank such that it could be regarded as unconscionable? Had the bank taken unfair advantage of its superior bargaining position for its own commercial gain?

Here the bank was in a superior bargaining position to the Amadios', as it knew both the financial position of the son and that his parents didn't fully understand what they were entering into. The parents were, in fact, in a position of special disadvantage because they didn't understand the extent of their liability under the agreement. Nor did they understand the financial position of their son's company, which was being propped up by the bank. Essentially, there was an abuse by the bank of its superior bargaining position in its dealings with the Amadios as they were clearly under a serious disadvantage (lack of English and no formal education). Once it was established that the Amadios' were under a serious

disadvantage, the onus shifted on to the bank to establish that the transaction was fair, just and reasonable.

From the facts, it appears that the actions of the bank manager in his dealings with the Amadio's would amount to unconscionable dealing due to their lack of knowledge or education and the consequent imbalance in bargaining power between the parties and as a result would be set aside. If the Amadio's has sought independent legal advice, or the bank had provided or suggested they got independent legal advice, then the unconscionability argument probably would not have succeeded.

Section 4 of the *Fairness of Transactions Act 1993* would, in addition to the common law would be available here for the Amadios.

Problem question

Another case involving the question of unconscionability. Read the facts again and note the actions of Ms Louth in relation to Diprose and don't forget t think about whether you would have decided the same way if the roles of the parties was reversed. Again, begin by explaining what you understand unconscionability to be and whether the relationship between the parties is one where there is a special disadvantage.

In its equitable jurisdiction the court may set aside a contract as unconscionable or unfair where there was inequality bargaining power between Louth and Diprose because of his infatuation with her, that is, Diprose was under a special disadvantage because of his infatuation which has caused him extraordinary vulnerability when she created a false crisis (on lying to him about being evicted). Unconscionable conduct leading to an unconscionable contract involves questions of fact and degree, and each case must be judged on its facts. If the facts show that the conduct of the defendant was such that in its factual setting fairness and good faith could properly be expected to be exercised, and it can be shown that they were not, then the conduct of the defendant bank may be described as unconscionable.

For a contract to be set aside on the grounds that it was unconscionable, the Amadio's must prove that:

- Diprose was in a position of 'special disadvantage' because of his infatuation.
- It must have substantially affected their ability to protect themselves.
- Lough must have known, or should have known of Diprose's 'special disability.'
- Louth had taken unfair advantage of his infatuation in a way that was unconscionable (that is, unfair or unjust).

From the facts, his infatuation led to vulnerability in the form of emotional dependence. As her conduct was unconscionable, the court would order that the ownership of the house be transferred to Diprose. If the position of the parties were reversed, then Louth probably would have been able to keep the house.

Chapter 10

Brass hired a roulette table, with all the ancillary equipment needed to play roulette, from ACME Hire. When they entered into the contract, neither party was aware of the provisions of their state's gaming and betting legislation that made the game unlawful but did not prohibit it. When Brass discovered the Act, he refused to pay the hire price. Can ACME Hire recover the hire charges?

The focus of the question is again on the question of legality. Is it a crime to be unlawful?

The question to consider here is what does the term "unlawful" mean? Is it the same as 'offence' or 'illegal'? Playing roulette under gaming and betting legislation is unlawful but not inherently criminal or illegal. The term 'unlawful' means something is not authorised or permitted by law. It is against the law and can result in legal consequences as a result of a person's actions that might be in breach of the gaming and betting legislation, but it is not necessarily criminal. No criminal sanctions are attached to the Act and nothing in the Act makes playing it a criminal offence as it is not prohibited. 'Illegal', on the other hand, refers to something that is prohibited, punished by law, and is carries a penalty.

The facts suggest that the agreement between the parties is an unlawful agreement. The terms of the agreement go against the gaming and betting legislation but while the agreement is unlawful it is not prohibited. Courts generally do not enforce illegal agreements and treat them as contracts void ab initio (they are void from the beginning) and the contract is treated as if it never existed. Neither party is bound by its terms. The unlawful conduct, that is, the playing of roulette, does not gives rise to a civil claim for damages.

Explain why a restraint clause in a contract of employment is most likely to be struck down by the courts. In what circumstances will a restraint clause be likely to be considered valid in a contract of

employment?

Note that there two parts to this question. The first part is asking you to explain why a restraint clause in a contract of employment is often struck down. The second part is asking you to comment on when such a clause may be valid. So begin by explaining what a restraint of trade clause is, then what its purpose is, and why they are often struck down by the courts. Then explain why there are exceptions to the rule where the restraint clause may be considered valid.

While a person should be bound by their contracts, one of the fundamental rights in contract law is a person's freedom to contract. Contracts, or clauses (called 'covenants') in contracts, that attempt to restrict or restrain the freedom of one party to contract are not illegal; rather, they are unenforceable at common law because they are against public policy unless it can be shown by the party relying on the clause is protecting a legitimate business interest such as goodwill, trade secrets or confidential information, and trade connections such as customer lists, and is reasonable. As a general rule, if there is an inequality of bargaining power between the parties, the courts will interpret these clauses contra proferentem; that is, strictly against the party relying on them (in this case, the employer). As a result, if the clause is merely an attempt to limit competition, the courts will usually find little difficulty in striking down the clause.

The following factors should be taken into account when trying to decide whether information was 'secret' and therefore protectable, or 'general know-how' and generally not protectable:

- the extent to which the information is known inside and outside the business
- the value of the information to competitors
- the effort spent in developing the information, **and**
- the difficulty in acquiring or duplicating such information.

In order for such a clause to be valid, it must be shown that:

- the restraint is reasonable, **and**
- there is some proprietary or legitimate commercial interest owned by the employer that requires protection**.**

In the case of **trade secrets**, an employer may generally validly restrain an employee from making any unauthorised use of that information both while working for them and for **a reasonable time after the contract of employment has ended**. An employer is entitled to protect and safeguard the confidential techniques they have developed. They could therefore legally restrain a former employee from using the information while employed by

a rival firm. However, note that while an employer is entitled to protect their trade secrets, they cannot prevent an employee from using their own skills and knowledge after they have left the employment, even if those skills were learnt from the employer.

Samson was employed as a computer salesman. Part of Samson's contract of employment contained the following clause. Is the restraint between Samson and his employer valid?

As this is a restraint of trade clause, explain what that means, how the courts view them, and what is required for it to be valid. Then apply to the facts.

Restraint of trade clauses are often included in contracts of employment as a way for employers to protect their business interests by restricting an employee's freedom to undertake certain activities during or after ending their employment. In order for such a clause to be valid, it must be shown that the restraint is legitimate, that is, that the employer has a legitimate interest in imposing the restraint, that it is reasonable in terms of time, and the scope of the restraint is no wider than reasonably necessary to protect that legitimate commercial interest of the employer.

From the facts here, the clause is a non-compete or non-solicitation clause which is intended to prevent Samson from starting a new job with another employer as a computer salesman, or enticing customers from his former employer. Has the employer got a legitimate interest to protect here? Where an employee has direct contact with the employer's customers as part of their work, are they given Samson's position, could he use those connections to entice customers away if he went to another employer? Would the courts recognise that here there is a legitimate interest that may be threatened by Samson going to another employer, and therefore his business requires protection?

But is the scope of the restraint reasonable? Whether a restraint is reasonable will depend on three key factors:

1. The duration of the restraint (in this case, 1 year);
2. The geographical area in which it is to have effect (no area specified, so geographical extent unknown); **and**,
3. The activities that it purports to control (that he not sell computers anywhere).

In this case the restraint is for 1 year, there is no geographical area specified, and the activities it purports to control, that is, to sell computers, is very wide. The restraint clause appears to be unreasonably wide and there seems to be no legitimate basis for having a restraint that wide on a computer salesman. It would seem to be doubtful that a computer salesman would have sufficient contact with customers for there to be a threat of luring

those customers away from the current employer to a new employer where the salesman had gone. The clause would be invalid.

Roberta was employed as a works manager with Littlewoods Recycling Works in Port Morseby. Her contract of employment contained a restraint of trade clause whereby she agreed that in the event of leaving Littlewoods she would not work in the recycling industry in PNG for five years from the time of leaving the company's employ. Roberta has been approached by a rival firm in Lae who has offered to double her existing salary if she will go and work for them. Roberta wishes to know whether the restraint clause in her contract of employment is valid. What advice would you give her?

Another restraint of trade clause question. Note that in this case though that Roberta, unlike the computer salesman in the last question, is in a much more senior position. Again, explain what that means, how the courts view them, and what is required for it to be valid. Then apply to the facts but note the length of this restraint.

Restraint of trade clauses are often included in contracts of employment as a way for employers to protect their business interests by restricting an employee's freedom to undertake certain similar activities during or after ending their employment. In order for such a clause to be valid, it must be shown that the restraint is legitimate, that is, that the employer has a legitimate interest in imposing the restraint on Roberta, that it is reasonable in terms of time, and the scope of the restraint is no wider than reasonably necessary to protect that legitimate commercial interest of the employer.

From the facts here, the clause is a non-compete clause which is intended to prevent her from entering or starting a similar profession or trade in competition with her former employer in the recycling industry for 5 years. Has the employer got a legitimate interest to protect here? Is there a legitimate interest that may be threatened here, and therefore require protection.

But is the scope of the restraint reasonable? Whether a restraint is reasonable will depend on three key factors:

1. The duration of the restraint (in this case, 5 years);
2. The geographical area in which it is to have effect (not be employed in PNG with a competitor); **and**,
3. The activities that it purports to control (that she not be employed by a competitor for 5

years).

In this case the restraint is for 5 years, the geographical area is for all of PNG, and she not work for a competitor, is very wide. The restraint clause appears to be unreasonably wide in terms of duration, geographical area, and too wide as it attempts to apply to any position with a competitor. The restraint is unreasonable as it would seem doubtful that as a works manager the employer would have a legitimate interest requiring protection and that the scope of clause is wider than reasonably necessary. The clause would be invalid.

Do the courts apply the same criteria in assessing whether a restraint clause in a contract of employment is valid as they do in a contract involving the sale of a business? Explain why.

In this question you should explain what the criteria for a restraint clause is in a contract of employment and a contract for the sale of a business.

Restraint of trade clauses are included in contracts of employment as a way for employers to protect their commercial interests or goodwill by restricting an employee's freedom to undertake certain activities during or after ending their employment. As a general rule, there is an inequality of bargaining power between the employer and the employee (favouring the employer), and as a result the courts will interpret these clauses contra proferentem; that is, strictly against the party relying on them (in this case, the employer).

In the sale of a business, where there is an element of goodwill, it is reasonable to expect that the purchaser would want to stop the seller from opening a similar business to the one they just sold within a certain area and time period so that they, as the purchaser, have time to establish themselves in the business. Here it is assumed that the parties are dealing on a 'more' equal basis, and there is a legitimate commercial interest that requires protection (such as goodwill), and as a result the courts are generally prepared to uphold the validity of such clauses.

While each case has to be treated on its own merits and it will be a question of fact as to whether the restraint is reasonable will depend upon a number of factors including the length of time of the restraint and its geographic extent (think about whether they were reasonable), the bargaining strengths and positions of the parties during negotiations, and the type of business.

In both cases, each case has to be treated on its own merits and it will be a question of fact whether the restraint is reasonable. The main difference between the two is the assumption that the parties involved in the sale of a business are dealing on a 'more' equal basis and that there is a legitimate commercial interest that requires protection in the form of goodwill.

We asked you above that if you were to buy a Toyota dealership you would expect that you would not want the seller establishing competition just down the road but, if you bought a milk bar or cafè, for example, the geographic restraint might be just a couple of kilometres if it is in town (or more in the country). What we did not ask you is whether you would you use the same restraint clause in both purchases? Explain why or why not.

In this case you are being asked to give your opinion, that is, can you use the same restraint clause if you were to buy a Toyota dealership as a milk bar? Remember that in the sale of a business what you are interested in protecting is the goodwill of the business. Think about the two types of business and whether there are a lot more milk bars than Toyota dealerships. Think about the cost of purchasing each business. Think about why the difference is important.

In any type of business situation what is important for the business to be successful is goodwill. Goodwill is an intangible business asset that does not have a fixed value. Among other things, it represents the value of a company's brand name, its customer relationships and their loyalty, and is classified as an intangible asset on the balance sheet.

The cost of buying a milk bar and the returns for the owner are much less than for a car dealership. This is reflected in the goodwill and the price you would pay for a milk bar when compared with something like a Toyota dealership. To protect your goodwill in a car dealership you would not want the seller to set up in competition down the street from you, or even in the next suburb, as your customer is much more likely to travel a greater distance to get what they want because they are paying so much for a car than anything a milk bar has to sell.

As a result, the restraint clause for a Toyota dealership will always be more onerous to protect the goodwill of the new purchaser? Whether a restraint is reasonable will depend on the type of business and is evaluated on a case-by-case basis. The question in each case is what is reasonable to protect the parties. Thus, in the case of milk bar versus Toyota dealership:

1. The duration of the restraint (for the car dealership, a much longer restraint clause – why?);
2. The geographical area (much bigger for the car dealership than for a milk bar – again why?); and
3. The type of business (why?).

You could use similar clauses but they would differ in terms of duration, geography and because of the type of business activity.

Chapter 11

Does it make any difference whether a statement is a representation or a term?

If you explain what a representation is and then what a term is, you will see instantly what the difference is and why it is important.

A **representation** is a statement of fact, made by one party before or at the time of the making the contract, which leads the other party to enter into the contract. They are pre-contractual and **do not** form part of the contract, and **are not intended to be legally binding**. Thus, they are not actionable in contract law.

A **term**, on the other hand, says what the agreement is about and may be about what each party has to do, how they should do it, how long that should take, what it is that they have agreed to, the price, who will pay (and when, where and how payment will be made) to make the agreement work. The term can be express, and either oral or in writing, or implied **but** unlike representation, is intended to be legally binding.

So, in summary, there is a clear difference between the two words. The representation is not intended to be legally binding while the term is.

Explain the purpose of the parol evidence rule and how it is applied by the courts.

Note that there are two parts to this question. First, you explain what the purpose of the parol evidence rule is, and then how it is applied by the courts.

In the case of an **oral contract**, exactly what the parties said must be found as **a matter of fact**, and to this end the courts will admit as evidence all facts known to the parties, including both **actions and words** of the parties.

In the case of a **written** contract, the courts assume that all the terms agreed to by the parties are contained in the contract and a court will generally **not admit evidence of acts or words of the parties before the execution** of the document if it has the effect of adding

to, varying or contradicting the written agreement. This is because the courts assume that the parties' intention is contained within the 'four corners' (the text) of the contract.

This is a rule of evidence that states that additional oral evidence is not considered by the courts to contradict, vary, add to or subtract from its terms when a contract is complete on its face unless it results in hardship or injustice in which case oral evidence can be admitted:

- to prove a trade custom or usage;
- to show that the contract has not yet become effective;
- where the court is of the opinion that the written document contains only part of the agreement;
- to clarify any ambiguous language used in the contract;
- where, due to a mistake of the parties, their agreement was not accurately expressed in the written contract;
- to demonstrate that a description is false; or
- to determine how important the truth of the statement was.

In trying to ascertain the promissory nature of a statement, and whether it is a representation or a term, what matters will the courts take into account in trying to ascertain the intention of the parties? **Discuss**.

When trying to ascertain the intentions of the parties from the particular facts before it and whether a statement is a representation or term, the court will take into account the following matters:

- **How much time has lapsed between the making of the statement and the final agreement?** The longer the lapse of time between the making of the statement and the final agreement, the more likely it is to be treated as an inducement and not intended to form part of the agreement. When was the statement made?
- **Was the innocent party asked to check or verify the statement?** Here the statement is more likely to be an inducement.
- **Was the statement made with the intention of preventing the other party from finding any defects, and did it succeed?** Just note it is important to **look also at the context in which the statement was made**. If **the statement was made after the sale then it was a representation and unenforceable**, as the contract had already been finalised.
- **What importance did the parties attach to the statement?** Did the parties placed considerable importance on the statement? If a party did not rely on the statement, it would be a representation.

- **Did one of the parties have special skills or knowledge?** Where one of the parties had some special skill or knowledge not possessed by the other party with regard to the subject matter of the contract, then a statement would more likely be treated as a term.
- The relative knowledge and intention of the parties should be considered. **Which of the two parties is in the best position to know or ascertain the truth about the statement?**

Problem answer

As you asked the question about white ant immediately before entering into the contract, even though it was not a written term in the contract, and the seller's assurance immediately before you signed was intended to form part of the agreement between you and the vendor when considered in the totality of the evidence and it was intended by the parties to form a condition subject to which the contract was entered into, that is, a collateral contract and was of sufficient weight to overcome the parol evidence rule.

As an aside: *Could you have argued that the vendor had fraudulently misrepresented the true position of the house when stating that it did not have termites since any reasonable inspection would have revealed their presence and the extent of the damage caused by them? Do you think that the seller's statement was made with the knowledge that it was false or recklessly, without caring whether it was true or false?*

You could argue that the vendor had fraudulently misrepresented the true position of the house when stating that it did not have termites since any reasonable inspection would have revealed their presence and the extent of the damage caused by them. It could be argued that the seller's statement was made with the knowledge that it was made false or recklessly, without caring whether it was true or false but you need more information, for example, how desperately did he need to sell? Would the statement have helped the seller get a better price? Would the property not have sold if he declared it was full of termites?

Once a collateral contract is established, what does the plaintiff need to show for it to be valid and enforceable?

Note that the question is really in two parts. To answer the question you need to begin by explaining what a collateral contract is, and in the second part what you need to show for it to be valid and enforceable.

A statement which is not a term of the contract can sometimes be regarded as a collateral or a preliminary contract if it can be shown that the main contract would **not** have been entered into in the absence of the earlier statement.). In such a case the courts **may** be

prepared to enforce the promises made by the parties **before** they entered into the main contract. The consideration to support the defendant's promise in the collateral contract is the making of the main contract.

In order to establish a collateral contract regarding a statement of fact it is necessary to show that the person making the statement:

- intended it to be relied on (and not descriptive or representational); **and**
- it is not supported by past consideration (the promise is agreed before the statement is made); **and**
- it is consistent with the main contract

Does a collateral contract or promise override an exclusion clause?

Begin by explaining what a collateral contract is and how it works, that is, what its purpose is and whether the collateral contract can exist side by side (but separately) with the main contract. Then explain what an exclusion clause is and then answer the question.

A collateral contract can be a verbal statement or a separate written statement to the main contract where the parties to one contract enter into another contract. Once established, it exists independently of the main contract. It is essentially a promise that can be enforced but is not a term of the main contract.

An exclusion and limitation of liability clause, on the other hand, is an attempt by one party to exclude or limit their liability. For the exclusion clause to be effective, it is not necessary that the party receiving the offer has read it, but you must have taken reasonable steps to bring the clause to the other party's attention and it should be reasonable or fair.

The collateral contract must be consistent with the main contract and it must be promissory. If an inconsistency comes from the operation of an exclusion clause in the main contract, the collateral contract or promise will override the exclusion clause because it is the very thing that induces the injured party to contract.

Problem answer

Another problem question. This is a more difficult question because you are going to have to work out whether the recommendations of the speed of the boat were promissory and capable of being considered to amount to a collateral contract. So

explain what a collateral contract is and what needs to be established for it to be a collateral contract here based on the facts in the problem.

Was the recommendation of the speed of the boat capable of being considered promissory and thus a collateral contract? Was the representation in the letter a term of the main contract or a collateral promise? Although the statement as to the speed of the boat led you to entering into the contract, it was not promissory but rather an expression of opinion.

At the time of the letter, negotiations were still in progress and as is noted under 'Hints' you had three choices to consider:

1. You could have made the attainment of speed a condition, but you didn't; or
2. You could have made the boat builders promise that the boat was capable of achieving 23 km/h and not representational to be actionable; or
3. You could have used your own judgement based on what the boat builders said, which you did, and that statement was not promissory.

End result, no collateral contract and no remedy or 'so sad, to bad' for you.

Problem answer

In this case an assurance was given about how a particular clause was to operate. By reneging on the promise, the question is whether you actions were unconscionable? Begin by explaining what a collateral contract is, and how it is established. Then apply it to the facts.

Was the collateral promise consistent with the main contract? In this case, as the verbal agreement and the proviso in the written sublease over termination were inconsistent, it was not possible to infer a collateral contract. The courts will allow the collateral contract argument to succeed only if it can be established that the collateral promise is consistent with the main contract.

Explain why it is important to know what type of term/s are contained in a contract?

With this type of question, you need to explain what the three types of terms are and then in a final paragraph you can summarise why they are import, for example, because the remedies under each available to a plaintiff are different.

The type of term in a contract will determine the type of remedy that the party bringing a claim for breach will be entitled to. If it is a **condition it is a term that is vital to the**

contract. The parties consider it so important that its non-performance may be considered by the injured party as amounting to substantial failure to honour the contract at all, and thus may be regarded as grounds for **terminating the contract** (but note that any obligations still outstanding at the date of termination continue) **or suing for damages (or both).**

If it is a **warranty t**he parties consider it to be **a term of lesser importance** to the main purpose of the contract. If it is breached, injured parties must still perform their part of the contract, but they have the right to **sue for damages** for any loss that they may suffer as a result of the breach+.

The parties rarely indicate whether a term is a condition or a warranty; that is, an essential or a non-essential promise, depends on the intention of the parties. And even if they do, the courts may not be prepared to accept what they say!

It may happen that a term cannot be classified as a condition or a warranty until **after a breach of contract** has occurred. The courts have identified a further class of terms that lies between conditions and warranties, called **intermediate or innominate terms**. Here the court focuses on **how serious the effects of the breach** are on the contract, rather than attempting to classify the term that has been broken as a condition or a warranty. Has the breach deprived the innocent party of **substantially the whole benefit** that they should have derived from the contract?

How do the courts decide on the importance of a term?

In answering the question you need to begin by explaining what a term is. Then explain its importance to an injured party, that is, in the remedies available to them.

Having decided that the statement is a term, explain there are three different types of terms: is it a condition, warranty or innominate term? Explain each. A court will:

- **look at what effect the breach had** on the contract—if the breach has had a serious effect, it could be treated as a condition, or if the breach is not serious, it could be treated as a warranty or innominate term, **or**
- **apply an objective test**, looking at the case as a whole and considering the importance of the broken stipulation as an inducement to the plaintiff to enter into the contract. **Is the stipulation essential or of fundamental importance to the contract?** If the answer is ‘yes’, it is a condition. If it still considered to be a term but of lesser importance then it is a warranty or an innominate term. The presumption being the more important the term is to the contract, the more likely the term will be a condition. Subsequently, if a term is less important to the contract, it will more than likely be a warranty.

The reason it is important to find out what type of term it is that you are dealing with is found in the remedy available to the injured party, so comment here on the remedies available to the injured party, that is, for a condition, as it is of fundamental importance to the contract, the injured party can choose to end the contract and has the right to sue for damages. If it is a warranty, then the injured party can claim damages for the specific breach. If it is an innominate term, then the courts will classify the breached term according to the consequences and seriousness of the breach, and decide whether it should be treated as a condition or warranty

What is the difference between a condition precedent and a condition subsequent in a contract? Explain, giving an example of each.

Note here that you are required to do two things. One is to explain the difference between a condition precedent and a condition subsequent, so no need for great detail Second, make sure you give an example of each.

A 'condition precedent' and a 'condition subsequent' is that in the case of a **condition precedent** a contract does not exist until the term has been fulfilled or satisfied, for example, in a property purchase you, as a buyer, might want to include a clause such as 'subject to the ANZ bank agreeing to provide finance'. If you, as the buyer, can't get the finance, the agreement fails and there is no contract.

A **condition subsequent** is the opposite of a condition precedent. It is an exit clause that if it occurs will bring a contract to an end, for example, you purchase a car from a car dealer and part of the deal was that if you were not completely satisfied, take the car back within 7 days and get your money back. If you return the car within the 7 day period, that terminates the original contract.

Problem answer

With this problem begin by explaining what a condition and warranty are. Then look at the facts again and decide which should apply, explaining why based on the facts. DO NOT just say, breach of condition and damages but explain what the courts (or you) are looking for and the impact on the agreement between the parties.

Breach of a condition or warranty? Remember that breach of a condition allows repudiation and/or damages while breach of a warranty allows the innocent party to claim for damages only. The court will look at the contract as a whole and consider whether the promise was so important to the promisee that they would not have entered into the contract unless there

had been an assurance of a strict or substantial performance of the promise, and this was apparent to the person making the promise at the time.

In this case, it appears that it was of great importance to the producers that the season should start well, and the failure of Poussard to perform on the opening night and in early performances was a serious detriment to them. If the only viable alternative was to employ a substitute, and this could be achieved only by offering permanent employment at a higher rate of pay, then the failure on Poussard's part to perform on the opening night went to the root of the contract as it could only be interpreted as a condition and breach permitted the producers to fire her.

Problem answer

Note the fact situation here. You might think it is a repeat of the last question, but they are not identical. So, you have to read carefully. The key to this question is in the 'Hint'. So again, start with an explanation of condition and warranty and then apply to the facts.

Again, is there a breach of a condition or warranty given the above facts? Remember that breach of a condition allows repudiation and/or damages while breach of a warranty allows the innocent party to claim for damages only. The court will look at the contract as a whole and consider whether the promise was so important to the promisee that they would not have entered into the contract unless there had been an assurance of a strict or substantial performance of the promise, and this was apparent to the person making the promise at the time.

Bettini was an experienced operate singer and while late attendance to rehearsals because he had been ill did not mean that he could not be there on opening night. The attendance at rehearsals was subsidiary to the main purpose of the contract and could be treated as a warranty as his illness would not prevent him from performing the rest of his contract. Thus, while Gye might claim compensation for any loss he had incurred, he could not repudiate the agreement.

Problem answer

Here is a question that you have to read carefully. In fact, read it at least twice. The area of law you are considering appears to clearly stand out. It is about the operation of an exclusion clause, so begin by explaining what an exclusion is and what it does. Look closely at the facts and you will notice there is nothing about a document being given to you, or that you had to sign anything. As an aside, and just for your information, the question also raises an interesting on an area of law called

bailments in case you actually do run into this sort of problem where you might leave goods with someone for repair and then they damage them or don't do the repairs properly but still want their money.

The first issue relates to the question of an unsigned docket containing an exclusion clause as evidence of dropping of the laptop. The second relates issues to evidence of dropping off the laptop but signing the docket containing an exclusion clause and whether signing it makes any difference to liability.

Dealing first with the unsigned docket. Where the document is unsigned, the question is whether the 'customer' knew of and consented to the exclusion clause. If they did not, would a reasonable person have regarded the document as one that would contain contractual terms and not represent a mere receipt or acknowledgment? What would be reasonably understood as being the purpose of the docket Did the computer shop make you aware the docket may contain conditions? The docket handed to you would probably not be construed as a contractual document but rather an acknowledgement that the shop now had possession of your computer and the docket was evidence of this. When you came to collect your laptop, it was evidence that the shop had your laptop and you were the owner, and not a document containing an exclusion clause exempting the shop from liability for negligence.

This is in fact a **bailment** case, where the **bailee** (the computer shop) is relying on an exemption clause printed on the shops dockets to avoid liability, and the court is saying that the bailee must take reasonable steps to bring any conditions that limit the computer shop's liability to you as the **bailors** (customer's) notice.

Now turning to the **signed docket.** A party signing a document knowing that it contains contractual terms is generally bound by those terms, whether they have read the document it or not. **But** a person who signs a document containing an exclusion clause may not be bound if they have reasonable grounds for believing that the document was not contractual. In this case, as the exclusion clause on the docket was not drawn to your attention when you signed the docket, if such terms are to be effective then you must be given reasonable notice of what the docket was for and that it contained an exclusion clause if it is to be enforced.

However, just be aware that where there is no disparity in knowledge or bargaining power, no misrepresentation, fraud or duress, **a signature is a very strong indication of intention to be bound**.

Problem answer

When you look at this type of situation you have to begin by working out what the legal issue

is. In this case, the question is asking you to consider whether the exclusion or limitation clause is effective. Again, begin by explaining what an exclusion or limitation clause is and then how it operates. Then you can answer the question.

Where the document is neither a receipt nor an acknowledgment—for example, tickets for a sea cruise—did the passenger have constructive notice of onerous clauses in the document? Has the shipping company given passengers sufficient notice of the terms in the contract? This is a question of fact in each case. In this case the shipping company could not rely on the limitation clause contained in the ticket because it had not been sufficiently brought to the respondent's attention before the payment of the fare. Therefore, the clause did not form part of the contract.

As an aside, if you were a passenger you would be unable to recover your fare because there was **not** a total failure of consideration. You had received some benefit under the contract; that is, eight days of cruising. However, you would be entitled to damages for disappointment and distress because the object of the contract was to provide an enjoyable experience.

Problem answer

Another question on exclusion clauses and very important to read the facts carefully. Here you are being asked to comment on two issues, that is, you are a first-time visitor and then you are a regular passenger.

On the question of a first-time visitor trying to use the ferry, the crucial test is whether reasonable notice of the term has been given so that even a first-time visitor could not argue they were not aware of the entrance requirements on to and off the wharf. In this case, we are told it is above the turnstiles but what we are not told is how easy it is to see and read. These two issues go to the question of the reasonableness of the notice. But would a reasonable person, even a first-time visitor, expect to find express terms and conditions of travel on a commercial ferry? The answer is probably yes because it is 2024 and people today expect to find that the use of all forms of transport are subject to terms and conditions of travel.

Could knowledge of the terms and conditions be presumed where a person has travelled on the ferry numerous times? If you have travelled on the ferry numerous times, you should be aware of the conditions of travel and be bound by them as it could be assumed that you would have had reasonable notice of them.

Problem answer

Again, another exclusion clause question. As with the last two questions, begin by explaining what an exclusion clause is and what its purpose is, that is, what does it cover? In this case you also want to explain how the courts view such clauses. With that done, then you can look at the question again and apply the law to the facts.

When it comes to interpretation of exclusion clauses and assuming that they have been properly incorporated into a contract, the courts strictly construe them against the party who attempts to rely on the clause or term. This is known as the *contra proferentem* rule and the effect is that the court will 'read down' the clause unless it specifies the type of liability to be covered and any ambiguity will be resolved in favour of the injured party,

To be effective here, the clause must operate to protect Warwick & Co in both contract and tort but if you read the exclusion clause again you will see it applied only to protect Warwick & Co from its liability in contract, and not from their common law duty of care in negligence. Any ambiguities will be strictly construed against Warwick & Co. The clause only operates to protect Warwick & Co from breach of contract but not negligence.

If the clause had read: 'Nothing in this agreement shall render the owners liable for any personal injury to the riders in negligence or contract of the machines hired', that would have protected Warwick & Co?

It is interesting to note that clauses can be too specific. For example, '*Where the passenger occupies a motor-coach seat fitted with a safety belt, neither the operators nor their agents or cooperating organisations will be liable for any injury, illness or death or for any damages or claims whatsoever arising from any accident or incident, if the safety belt is not being worn at the time of such accident or incident.'* Do you see a problem? Would the clause protect the bus company if you stood to get your bag from an overhead locker, the bus suddenly braked heavily, and you were thrown to the floor and broke your leg. This was an Australian High Court case called *Insight Vacations Pty Ltd v Young* [2011] HCA 16 and here the court gave the words their ordinary meaning. The result was that the exclusion clause could operate only when passengers were seated. In this case Insight would probably have been better protected by removing any reference to 'seat'!

Problem answer

Don't worry about the fact this is a bailment case. Just remember it for future reference. Again, this is a case on exclusion clauses. In this case, note what the 'Hint' is asking you to do, so begin with an explanation of what an exclusion clause, what it is meant to do and how the courts construe them.

In this case you have an example of interpretation according to the express agreement. The effectiveness of an exclusion clause is purely a question of construction of the contract as a whole in each case. Is the term or clause wide enough to exclude an action for the alleged breach? In this case, the actions of the car park attendant in releasing the car to the thief were outside the terms of the contract you had with the Car Park. It was not merely a negligent act but a delivery not authorised or permitted under the contract.

Explain the operation of the contra proferentem rule. Is such a rule defensible today?

Note there are two parts to this question. First, it is asking you about the operation of the *contra proferentem*, so explain what the *contra proferentem* is, then how it operates, and finally whether there is still a need for it today.

Contra proferentem is a principle of strict construction against a party relying on clause or term, for example, to avoid liability such as an exclusion clause. Where the exclusion clause has been correctly incorporated into the contract it will be strictly construed against the party who attempts to rely on it. The courts will 'read down' such a clause unless it specifies the type of liability to be covered and any ambiguity will be resolved in favour of the injured party.

In the case of commercial contracts, there is a greater equality of bargaining positions that can exist between the parties because of access to lawyers. However, the same is not necessarily true where consumer contracts are concerned as they are generally the weaker party in commercial transactions. There is generally no equality of bargaining position between suppliers and consumers with the result that consumers, particularly where standard contracts are used, have to accept terms and conditions that can produce a harsh and/or unfair result for the consumer in the event of a breach.

The *contra proferentem* rule provides that where a contract contains an ambiguous term (or clause), the terms should be interpreted against the person who drafted the contract (or the party who wanted it included in the contract) and to that end it introduces a degree of equality between the stronger party and the weaker party (the consumer). Because standard form contract documents often lack a genuine bargaining between the parties resulting in inequitable positions, the *contra proferentem* rule helps to mitigate unfairness by applying the interpretation that gives benefit of doubt to the party upon whom the contract was forced, that is, the consumer.

In order for a party to rely on an exclusion clause, what must they show?

Again, it is useful to explain what an exclusion clause and what its purpose is, then go on and explain what the person who wants to rely on such a clause must do. Just remember, that unless the exclusion or limitation clause is incorporated into the relevant contract, it will be unenforceable. And even where it is, does the clause cover the liability in question?

Signed documents

A person who signs a contract containing an exclusion clause will be bound by it as an express term of the contract, even if they have not read it, unless fraud, misrepresentation, or a statutory defence can be established.

Unsigned documents

For exclusion clauses to be effective in an unsigned contract, the following points should be noted:

- That the 'customer' knew of and consented to the clause? If they did not, would a reasonable person have expected to find such a clause in that type of document?
- That reasonable steps were taken to give sufficient notice of the term?
- If the terms have not been brought to the notice of the 'customer', can they be implied by trade usage or custom trade?

In the case of a signed contract, can the party signing limit their liability in both contract and tort?

Yes. See problem question *You hired a bike from John Warwick & Co* (and answer above) where Warwick & Co could have been protected if their clause had read: 'Nothing in this agreement shall render the owners liable for any personal injury to the riders in negligence or contract of the machines hired'. This wording makes it clear to the other party that Warwick & Co are not accepting any responsibility for any customer hiring a bike who gets injured because the bike has not, for example, been properly serviced Remember that there is an overlap between negligence (and duty of care owed to a bike user that the bike is roadworthy) and contract (and an implied duty of care that the bike is roadworthy).

Chapter 12

If the creditor has not expressly indicated that payment must be by post – for example, if the account reads 'Payment within 7 days' rather than 'Payment within 7 days by post' – loss of the letter and its contents is borne by the debtor, irrespective of what past practice has been unless payment is in another city or a great distance away. Explain why

Note what the question is asking you to do and that the focus is on the creditor.

Payment by post can occur by way of request by the creditor or on the initiative of the debtor, but note that the consequences will differ depending on which way it occurs.

If the creditor requires payment to be made by post, the normal rules of contracts by post apply. When the letter is lodged at the post office, this is considered as a discharge from liability for the debtor if the letter is lost in transit as the post office is the agent of the creditor. The debt itself is discharged when the claim connected with it is made on the debtor's bankers.

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*W*here there has been partial performance of a contract, does payment still automatically follow for the party in breach? Explain why.

Again, note what the question is asking you to do, that is, comment on whether the party in breach can still request payment where there has been partial performance, and explain why.

Where there has only been a partial performance, payment does not automatically follow unless the contract is divisible, that is, it can be divided up into its component parts (which is a question of construction), or there has been free and willing acceptance of partial performance by the party receiving the benefit, or substantial performance has taken place, or the actions by the non-performing party prevent performance.

If the breach is minor, so that the cost of rectification is small when compared with the contract price, the **doctrine of substantial performance** may still permit the defaulting party to obtain the contract price. Each case turns on the construction of the contract. Whether or not there is a substantial performance is essentially a question of fact. This can be assessed by taking into account both the nature of the defects and the proportion between the cost of rectification and the contract price, the benefit obtained by the owner, whether the work is entirely different from that contracted for, or whether the contractor has abandoned the work.

If one party is prevented from performing, the other party may regard the contract as being at an end and the party being prevented from performing will be released from any further obligations and can:

- terminate the contract;
- claim for damages for breach of contract;
- terminate the contract and claim for damages; or
- if performance had commenced but had not been completed, claim on a *quantum meruit*.

The seller agreed to supply 4500 tonnes of wheat to the buyer. The contract allowed a variation of 2% on weight and a further 8% on contract quantity. The seller delivered 25kg more than the maximum allowed under the contract but never claimed payment for the surplus. Can the buyer reject the whole cargo solely on the ground that the quantity tendered was 25kg over the contract quantity? Explain.

A short problem question but this time with no hints. So look carefully at the facts and consider whether the buyer is in breach of contract, then explain why you think they are (or aren't) in breach. Has there been a substantial departure from what was agreed in the contract?

Where there is a variation from the terms of the contract, the parties will be discharged from any obligations provided that the performance of the contract corresponds as closely as practicable with the terms of the contract. The strict rule of complete and precise performance applies only if the contract is entire— that is, it cannot be divided up. Contracts for sale of goods are usually treated as requiring entire performance. If variation is only minimal or trivial, the courts will generally not worry about it. But each case will have to be determined on its facts, and in each case the question to ask is whether there has been a substantial departure from the contract.

Hoenig was employed to redecorate and furnish Laura's flat for K1500, to be paid as follows: 'Terms of payment are net cash, in three instalments of K300 as the work proceeded; and balance of K600 on completion'. Laura paid K600 to Hoenig. The work was done poorly, and the cost of rectification was K350. Hoenig was not happy. Can he recover the balance of K900 from Laura?

Here you need to consider what sort of contract there is between the parties. Is it divisible or entire? So, begin by explaining the difference divisible or entire contracts and then look carefully at the facts here.

This is an example of a divisible contract because it is divided up into three parts. If the breach is minor, so that the cost of rectification is small when compared with the contract price, the **doctrine of substantial performance** may still permit the defaulting party to obtain the contract price. Hoenig was entitled to recover the contract amount less the cost of rectification, because the contract had been substantially performed and the defects were easily rectifiable.

Each case turns on the construction of the contract. Whether or not there is a substantial performance is essentially a question of fact. This can be assessed by taking into account both the nature of the defects and the proportion between the cost of rectification and the contract price, the benefit obtained by the owner, whether the work is entirely different from that contracted for, or whether the contractor has abandoned the work.

An English firm agreed to sell and deliver machinery to a Polish company, which paid £1000 (nearly K5000) in advance. The English firm commenced work on the machine, but because of the outbreak of war and the German occupation of Poland, the contract was frustrated. The question of frustration was not in issue; the Polish company claimed the right to recover the deposit it had paid before the frustrating event. The English firm claimed that it had done a considerable amount of work on the machine. What is the effect of frustration in this case?

Another problem question. From the facts, you are told what the problem is: frustration. Begin by explaining what frustration is and then look again at the facts and decide whether there has been a total failure of consideration.

Like the last question, this is also a question on the application of the doctrine of frustration. The effect of a frustrating event is to discharge a contract immediately, **but** only as to the

future. The contract is not void ab initio (or void from the beginning) but void only from the time of the frustrating event.

For the period that the contract is valid, any obligations that arise must be fulfilled. Money paid under the terms of the contract before the frustrating event occurs (for example, a deposit) cannot be recovered, because at the time the money was paid the contract was valid. You would need to establish a total failure of consideration to be able to recover the money.

Is there a total failure of consideration here? Did Fibrosa get anything for the money it had paid? As the machinery had not been delivered because of the outbreak of war, there was a total failure of consideration and as a result Fibrosa is entitled to get its deposit back. The expression 'total failure of consideration' should not be seen as meaning that there is no consideration. In this situation, it means that Fibrosa has got nothing under the contract. As they had already paid K10,000, that money can be recovered. But the principle only applies if Fibrosa has got nothing under the contract, If Fibrosa had received part of the machinery before the contract was frustrated, the K10,000 would not be able to be recovered because there would not have been a total failure of consideration.

Imagine you wanted to hold a concert and an express term as to the purpose for which the hall you wanted to use was that it was in a fit state for a concert. Unknown to the parties the hall burnt down without their knowledge while they were still negotiating. A contract was subsequently entered into and both parties at the time of entering into a contract believed that the hall still existed. Has the contract been frustrated? Explain why or why not.

Another problem question. From the facts, you are told what the problem is; has the contract been frustrated? So again, begin with explaining what frustration is and then look again at the facts and decide whether there has been a total failure of consideration.

This is a question on the application of the doctrine of frustration and the effect of impossibility owing to the non-occurrence of an event basic to the contract. If the entire basis of a contract is the happening of some event that doesn't occur, the contract may be discharged as it is no longer possible to achieve the substantial purpose of the contract.

While the contract doesn't contain any express reference to what the hall is to be used for, the only inference that could be drawn from the surrounding circumstances was that both parties to the contract assumed that the hall could be used for a concert and that this was

the basis of the contract. When the basis or underlying object for which the parties entered into the contract ceases to exist, the contract is dissolved.

Why do the courts refuse to enforce penalty clauses in contracts?

Begin by explaining what a penalty clause is, then you can explain why the courts don't enforce them.

A penalty clause included in a contract is a threat to ensure performance, and is imposed on the weaker party by the stronger party. If the sum is clearly extravagant and totally out of proportion to the amount of loss suffered by the injured party, then it is probably a penalty and so not enforceable. Only the actual loss sustained can be recovered.

The courts are often faced with the problem of deciding whether a sum is a penalty or liquidated damages. They don't attach great importance to what the parties may like to call 'the sum' in the contract. The question in each case is whether the sum can be seen as a genuine pre-estimate of the damages that will result from a breach or a sum intended to punish the other party in the event of a breach. This is a question of construction to be determined by the circumstances and on the terms of the particular contract at the time of its making (not at breach) and the reason that the courts don't enforce penalty clauses is that they are often unconscionable or unfair under common law or contrary to statutory provisions of 'unconscionable conduct' and 'unjust' or 'unfair'.

Remember that as a general rule, penalty clauses are imposed on the weaker party by the stronger party.

Explain the difference between liquidated and unliquidated damages and a penalty.

Start by explaining what liquidated and unliquidated damages and a penalty are, then what is the difference between them.

Liquidated damages are a fixed amount in the contract. The parties agree to what should be sum-based paid in the event of a breach, and the clause is known as an 'agreed damages clause'. It must be a genuine or bona fide pre-estimate of actual loss that will flow from the breach.

Unliquidated damages are awarded when **a** plaintiff is unable to assess precisely what should be the amount of recoverable damages be — for example, for pain and suffering or disappointment. In most cases, no amount is mentioned in the contract and it is left to the court or the jury to determine what amount should be awarded.

A penalty is an amount agreed on as a security to ensure that a contract will be performed. It is a threat to ensure performance, and is imposed on the weaker party by the stronger party.

Explain why an injured party to a contract should have to mitigate their loss.

Begin by explaining what mitigation of damages means and from there explain why an injured party has to minimise their loss.

The law imposes a duty on the person claiming damages (the injured party) to take all reasonable steps to reduce or minimise (mitigate) their loss. The innocent party, that is, the party not in breach, cannot take advantage of the defendant's breach as that would expose the breaching party to unfair liability.

If persons claiming damages fail to take this step, the amount of damages they can expect to recover will be reduced. If the plaintiff is able to avoid a loss, damages will not be recoverable for the potential loss that the plaintiff may have suffered.

Joad Tyres sold car covers and other motor accessories to Casey under a contract which provided that Casey would not sell any of the items below certain listed prices. In the event of breach of the agreement, Casey agreed to pay K50 in liquidated damages for every item it sold below the listed price. Casey subsequently sold a tyre below the listed price and was sued by Joad Tyres. Would you classify the sum as a penalty or liquidated damages? Explain why.

Another problem question. Begin by identifying the problem, which you are told is breach, and explain what that means, then what are liquidated damages and a penalty. You can then classify the sum.

In effect, this is an amount agreed on as a security to ensure that a contract will be performed. It is a threat to ensure performance, and is imposed on the weaker party by the stronger party. If the sum is clearly extravagant and totally out of proportion to the amount of loss suffered by the injured party, then it is probably a penalty and so not enforceable. Only the actual loss sustained can be recovered.

The courts are often faced with the problem of deciding whether a sum is a penalty or liquidated damages. They don't attach great importance to what the parties may like to call 'the sum' in the contract. The question in each case is whether the sum can be seen as

a genuine pre-estimate of the damages that will result from a breach or a sum intended to punish the other party in the event of a breach. This is a question of construction to be determined by the circumstances and on the terms of the particular contract at the time of its making (not at the time of breach).

In this case the amount of K50 is probably a genuine pre-estimate of loss flowing from the breach and not 'extravagant and unconscionable'. The onus is on Casey to show that the late fees were penalties. The test in this type of case was whether the K50 per item was 'out of all proportion' to the interests of Joad Tyres, the party it was protecting. What we don't know here is the value of the car covers and other motor accessories which would then have provided us with a guide as to whether K50 was a penalty but on the information given it probably was a genuine pre-estimate.

You arranged a 2 week holiday in Switzerland through a brochure from Swans Tours. The brochure claimed the accommodation was close to the ski fields, its owner spoke English, and there would be a welcome party on arrival and a farewell party on departure at the bar. However, few of the statements proved to be correct and the trip turned into a disaster. What would you do?

I would assume that you would give serious thought to suing for breach of contract. But your problem would be whether you could claim damages. So the first thing you are going to need to do is to explain whether the courts will grant damages for a spoilt holiday, and if so what sort of damages would your claim be based on. Does it matter that it would be hard to assess the amount of damages?

While the courts will generally not grant damages for anything other than provable or economic losses, in certain instances, the courts will allow a claim for damages by an injured party for breach of an express or implied term that the promisor would provide them with pleasure, enjoyment or personal protection, and the failure to do so has caused physical injury or inconvenience to the plaintiff. The damage claimed must be a direct result of the breach, and remoteness is not an issue.

On the issue of the recovery of damages for the disaster called a holiday, as few of the statements in the brochure proved to be correct, the object of the contract, which was relaxation and enjoyment as promised holiday in the brochure, did not live up to expectations, you should be entitled to damages for disappointment and distress.

The fact that it is difficult to determine the amount of damages is not a ground for disallowing a claim. Where this is difficult, or where the loss is of a speculative nature, the court will

determine the amount of damages based on you being able to show on the balance of probabilities that the loss of chance was of some value.

The defendant leased a racehorse to you for 3 years. After 6 months, the defendant took the horse back. As part of the damages claim for breach of contract, you sued for loss of potential prize money and profits that you would have made from betting on the horse. Do you think you would succeed in your claim? Why?

Again, a problem question, and the question tells you the area, that is, damages. So begin by explaining what are damages and how they are generally assessed. Here, the claim is of a speculative nature and what you are going to have to address here is whether the courts can determine the amount of damages, or even hear the matter.

The question here is where it is difficult to assess the amount of damages, should your claim be dismissed? Where it is difficult, or where the loss is of a speculative nature, the court will determine the amount of damages based on the plaintiff being able to show on the balance of probabilities that the loss of chance was of some value. You will be entitled to recover damages for potential loss of prize money and profits you could have made as you have suffered a loss. The courts will exam all the material in order to arrive at what they believe is a reasonable approximation of the loss suffered by you.

Explain under what circumstances a quantum meruit claim would arise.

Begin by explaining what quantum meruit means, noting that it is a claim in equity, and then you can go on and explain when such a claim would arise.

Quantum meruit means ‘as much as the person has earned’ and is a claim in equity. It is essentially an action for payment of the reasonable value of good supplied or services performed. The contract may be discharged by breach, but where the contract is for goods or services there is a new implied contract imposed by law on the party taking the benefit that they will pay a reasonable amount for the quantum or portion given. It is not available to the party in breach.

Quantum meruit most often arises where there has been a contract but it has been frustrated, made void, terminated or is otherwise unenforceable but it can also arise:

- where a defendant has prevented a plaintiff from carrying out the remainder of their

contractual duties;

- where the parties cannot agree on payment;
- where the innocent party to the contract is faced with a repudiation by the other party and decides to terminate the contract in response; and
- where the parties agree on payment for the part-performance but not the actual amount.

Henrietta engaged a firm of solicitors to obtain an injunction to prevent a former friend from visiting her and making a nuisance of himself. An unqualified litigation clerk was given the matter to handle, but his incompetence created further embarrassment for Henrietta. Does Henrietta have any claim against the firm for 'mental distress and upset'?

A problem question. This is an interesting question because it raises two issues. It takes you back to what you looked at in Chapter 2 and the issue of, in this case, vicarious liability, that is, are the actions of the litigation clerk linked to their employment and thus capable of making the employer liable. But it also raises an issue of contract that you should deal with, that is, the engaging of the firm by Henrietta creates a contract. Hands up those who picked up the two possible actions? The second issue then is the one of damages and whether they are claimable for mental distress and upset.

There are two questions to consider here. First, is the firm liable for the actions of litigation clerk? Secondly, are damages recoverable for mental distress?

Liability of the firm for the actions of their litigation clerk in failing to carry out their duties raises the issue of vicarious liability which is a tort. The clerk was acting in the course of their employment and so the firm can be held responsible for their clerk's actions in negligently handling Henrietta's matter. The elements of duty, breach and damage would all appear to be satisfied. But in addition to the potential tort action there is also a breach of contract action available to Henrietta. There is an implied term in the contract with the firm that they will carry out their duties in a professional manner which they have failed to do by failing to ensure that the clerk was handling Henrietta's matter competently. A breach of contract.

In addition to expectation and reliance losses, damages may be recovered for losses that arise from mental distress as long as she can establish that she has suffered damage caused by the breach of contract and it falls within the relevant principles of remoteness of damage. Damages for disappointment and distress are not recoverable unless they proceed from physical inconvenience caused by the breach. What is certain is that damages for disappointment and distress arising from breach of contract will be recoverable

where the object of the contract is to provide peace of mind or freedom from distress. In such cases the damage can be said to flow directly or arise naturally from the breach as there is a failure to provide promised benefits.

Josef, a well-known film actor, entered into a contract with Frère Bros for a period of five years, where he agreed to give his services exclusively to them and not act in films for any other company during this period. During the first year of the agreement, Josef entered into a contract to star in a film being made by Pretty Pictures. Do Frère Bros have any remedy? Explain why.

Another problem question. This is one of those questions you have to read very carefully. Is the contract Josef has with Frere Bros exclusive, that is, Josef cannot work for anyone else for 5 years valid? Note the use of the word 'exclusive', so you need to explain what that means in the context of Josef's contract. Is there a breach of contract by Josef and if there is, what remedies do Frere have? The best option here for Frere would be an equitable remedy – an injunction, so explain what an injunction is and why it would be better than specific performance in your answer.

Frere Bros could seek an equitable remedy in the form of an interlocutory injunction to stop Josef working for Pretty Pictures. As the matter here involves personal services, specific performance is not available because of problems in enforcing the contract by the court but such a problem doesn't exist with an injunction.

An interlocutory injunction is the best option as it can be used to restrain Josef from breaking his contract but note it will not be awarded if damages are an adequate remedy, which in this case is probably not an issue as it appears from the facts that Frere Bros are keener to keep his services (he signed a 5 year deal with the move company).

Initially the company should seek an interlocutory injunction as this preserves the subject matter of the dispute, that is, the contract with Frere Bros, and the status quo between the parties is maintained until the dispute can be heard by the court—it does not decide the rights of the parties and is generally only obtained in the case of urgency. By granting an injunction against Josef preventing him from acting anywhere else during the term of his current contract Josef is not being forced to work for Frere by the court's granting of an injunction. Josef could choose to work in some other profession than acting that had nothing whatsoever to do with the business of the employer.

Chapter 13

Problem answer

A problem question. Just note that with this problem there are three questions for you to consider.

The first is the question of whether painting a portrait was a contract for the sale of goods. The second question then follows on from the first and that is if it is not a contract for the sale of goods, is it a contract and there are no rights. Don't forget to consider the final question. Does the death of one of the parties make any difference to your answer? This raises the question of whether the contract was one of personal services.

In this case what is the main purpose of the agreement? Is it to transfer ownership of goods? If it is, it is a contract for the sale of goods. But if the main part of the agreement is the skill and experience to be displayed by one of the parties in performance of the contract, such as the painting of a portrait, and the transfer of title to the materials is of secondary importance, it is a contract for work and labour and the supply of materials.

Even if it is not a contract for the sale of goods, all that means is that doesn't attract the attention of the *Goods Act.* The verbal agreement to paint a portrait is still a contract but as it is for services, it does attract the attention of the *Goods Act.*

The effect of the death of one of the partiers on the contract will depend on whether the agreement is one for personal services or not. If it is for personal services and both parties are required to personally perform obligations if the contract is to be fulfilled, then the death of either party will bring the contract to an end.

What is the meaning of the following terms, giving an example in each case:

1. specific goods
2. future goods
3. unascertained goods.

With short answer questions, you should aim at answering them in a couple of lines. Note that in addition to explain the meaning of the word, you have to give an example.

1. Specific goods are goods identified and agreed on at the time of the contract of sale, for example, a year 2024 white Ford Ranger.
2. Future goods are goods to be manufactured or acquired by the seller after the making of the contract for sale, for example, a sale by a dealer of a new 2024 Ford Ranger that is yet to be made.
3. Unascertained goods are goods that are defined by description only. They are not identified and agreed on when the contract is made, for example, a bag of Sugar from the lot of one thousand bags.

Into which classification would the following goods be placed?

1. 10 kilograms (kg) of sugar out of a 100-kilogram bag of sugar
2. an LCD flat-screen TV on display in a shop
3. a second-hand blue Toyota Camry car.

Another short answer question. Unlike the last question, you are not asked to do any more than say into which classification the following fall.

1. 10 kilograms of sugar out of a 100 kilogram bag of sugar – unascertained;
2. an LCD flat-screen TV on display in a shop – ascertained
3. a second-hand blue Toyota Camry car – specific.

Explain the purpose of a Romalpa clause in a sale of goods contract. What impact, if any, has the Personal Property Securities Act 2011 had on Romalpa clauses?

You need to do three things to answer this question well. First, begin with an explanation of what a Romalpa Clause is. Second, explain its purpose. Finally, explain what the *Personal Property Securities Act* is and its impact on Romalpa clauses, if any.

A Romalpa clause in a contract is a retention of title clause. Its purpose in a contract for the sale of goods is to protect the seller of goods by ensuring that the title to the goods remains vested in the seller until the buyer complies with certain obligations (usually payment of the purchase price).

The *Personal Property Securities Act 2011* covers security interests over personal property other than land. A security interest is an interest in personal property that in substance

secures payment of a debt or other obligation. In addition to covering standard forms of security such as chattel mortgages, the definition also covers retention of title clauses in contracts under which a purchaser has possession of property but does not acquire title from the vendor until the full purchase price is paid.

If the buyer defaults, or goes into receivership or liquidation, the seller may lose the goods if they haven't used a 'reservation of title' or 'Romalpa' clause to reserve title or legal ownership over the goods and registered their interest in the goods with the Personal Property Securities Registry. If the buyer defaults, the seller may be able to get the goods back from an innocent third party.

Problem answer

Another problem question. In this question you have to decide what area of the Goods Act might apply. Look again at the facts and what you are looking for is when did the property (ownership) in the kidneys pass from the seller to the buyer? Remember that risk passes from the seller to the buyer when property or ownership pass from the seller to the buyer.

The question here is whether the kidneys are ascertained or unascertained goods. If the goods are ascertained, property and risk will have passed to the buyer. On the other hand, if the goods are unascertained property and risk will have remained with the seller.

As the buyer's goods had been identified as they were sitting on the pavement awaiting collection by the buyer's carrier, property and risk had passed to Wardar they would have to bear the loss under s 18(3)(a)). of the *Goods Act*.

The seller agreed to supply 4950 tonnes of wheat to the buyer. On delivery, the buyer discovered that it had received only 4895 tonnes, a shortfall of 55 tonnes, and so refused to accept delivery. Can the buyer reject the whole delivery? Advise the buyer.

Another problem question. Remember that the general rule when dealing with quantities of goods under the *Goods Act* is that the seller should deliver the exact quantity of goods ordered by the buyer. Has that happened here? Or is there an exception to this rule?

It is the duty of the seller to deliver the exact quantity of goods ordered by the buyer. However, a trifling difference doesn't give the buyer the right to reject the goods, although this is subject to trade usage, special agreement, and the course of dealing between the parties (s 30 of the *Goods Act*).

Remember in the last Chapter relating to discharge and breach it was noted that the strict rule of complete and precise performance applies only if the contract is entire— that is, it cannot be divided up. Contracts for sale of goods are usually treated as requiring entire performance. **But** if variation is only minimal or trivial, the courts will generally not worry about it. However, each case has to be determined on its facts, and in each case the question to ask is whether there has been a substantial departure from the contract. In this case, the sellers have substantially performed the contract.

Coca-Cola purchased 200,000 yo-yos, to be delivered in instalments. They were to be used in conjunction with an advertising program by Coca-Cola. Of the first 85,000 yo-yos delivered, 65,000 were returned as defective. Coca-Cola wants to terminate the contract. What percentage of yo-yos do you think Coca-Cola should have to accept delivery of?

Another problem question. Unlike the last question where the variation was trivial, in this case the question relates to rules of delivery in a contract of sale of goods and acceptance where 85 % of the yoyos were defective. Should Coca-Cola be able to terminate the contract or by taking delivery have Coca-Cola accepted the yoyos?

Under the *Goods Act*, the buyer by taking delivery of the yoyos has the right to inspect the goods for defects. Section 34(1) of the *Goods Act* provides for a buyer's right to examine the goods where goods are delivered to the buyer and he has not previously examined them, he shall not be deemed to have accepted them until he has had a reasonable opportunity of examining them for the purpose of ascertaining whether they are in conformity with the contract.
In this case, given the percentage of yoyos that were defective was 85 %, Coca-Cola would be able to rely on s 34(1) as what was delivered was not in conformity with the contract.

Who is an unpaid seller? Briefly explain.

Note the question asks you to 'briefly' explain who is an unpaid seller.

An unpaid seller includes any person who is in the position of the seller, such as an agent for the seller, and who:

- has not been paid the full price or has been paid with a bill of exchange or cheque as conditional payment, but which cheque or bill of exchange has been dishonoured.

Where an unpaid seller exercises a lien over goods, what is the

seller doing?

Explain what a lien is, and then explain what the seller is doing.

A 'lien' is a legal right of a seller to hold or retain possession of goods for performance of an obligation by a buyer, which in this case is for payment of goods.

Discuss whether the unpaid seller has a right of resale of goods under a contract for the sale of goods. What rights do you have as a buyer under the Goods Act if the goods you purchase are faulty?

In this question there are two parts. The first relates to the rights of an unpaid seller while the second part what rights you have if the goods are faulty.

The unpaid seller's rights depend on whether or not the property or possession of the goods, or both, have passed to the buyer:

- Damages for non-acceptance;
- Where property and possession have passed to the buyer, the unpaid seller has rights only against the buyer personally.
- Where the unpaid seller has possession of the goods or they are still in transit to the buyer, the seller may:
    - exercise a lien on the goods for the price—that is, the right to retain possession until the price is paid;
- in the case of insolvency, exercise the right of stopping the goods in transit, notwithstanding that the goods are no longer in the possession of the seller; and
- have a right of resale.
- Where property in the goods has not passed to the buyer, the unpaid seller has, in addition to the other remedies, the right to withhold or stop delivery of the goods.
- Where the seller has property and possession, the goods may be resold without the seller committing a breach of contract.

Assuming the faulty goods cost more than K20 (s 6 of the *Goods Act*), the buyer may be able to rely on s 15(2)(b) of the *Goods Act* that where goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods are of merchantable quality. Depending on what the faulty goods are, s 15(2)(c) may also be able to be relied on as there is an implied warranty or condition as to quality or fitness for a particular purpose that may be annexed by the usage of trade. Breach of a condition is treated under s 12(4)((4) can only be treated as a breach of warranty. Remedies available to a buyer for breach of warranty are damages (s 53).

Chapter 14

A racehorse was consigned by rail for Swaffield at one of the plaintiff's railway stations. Swaffield was not at the station when the horse arrived, as it arrived late at night. The railway company didn't have his address, so there was no way it could get in touch with him to tell him the horse had arrived. As the horse couldn't be kept at the station, it was sent to a stable at the company's expense. When the railway company sought to recover the expenses for the upkeep of the horse, Swaffield refused to pay. Do you think the railway company will succeed in their claim?

A problem question and the area of law is agency. How do you know this is an agency question? The railway company is transporting Swaffield's horse for him. Begin by explaining what an agency relationship is, then apply each of the conditions to the facts in the problem and come to a conclusion.

This is a case of agency involving a case of necessity or emergency four conditions must be satisfied:

1. there must be a **genuine emergency** where the principal's property is in physical danger; **and**
2. it must be **impossible** or extremely difficult to get the principal's instructions; **and**
3. the person must be **entrusted** with another's property; and
4. the agent must act ***bona fide*** in the principal's interests, and not merely for the agent's own convenience.

In this case, it can be argued that the railway company was an agent of necessity as the four conditions for an agency by necessity are satisfied. First, there was a genuine emergency as the horse couldn't be kept at a railway station at night. Second, it was impossible to get in touch with the owner of the horse as it arrived late at night. Third, the railway was entrusted with Swaffield's horse. Finally, by sending the horse to a stable and feeding it, the company was acting *bona fide* in the best interests of Swaffield by looking after the safety and well being of his horse. The railway company should then succeed in their claim.

Lambert made an offer to buy land from an agent who in fact was manager and agent of the property on behalf of Bolton Partners. The agent had no authority to act for Bolton Partners, but he

accepted the offer on their behalf. Lambert then sought to revoke the offer. Bolton Partners subsequently ratified the acceptance of the agent. The question here is whether the unauthorised actions of the agent could be ratified by the principal. What do you think?

In this case the question tells you what are of law you need to look at. So begin by explaining what agency and the principle of ratification are. Then set out down the conditions that need to be satisfied for ratification to be effective and whether the actions of the agent could be ratified by Bolton.

An agency relationship exists when you (the principal) give your authority to another (an agent) to enter into a contract with a third party which will be enforceable both for and against you (as long as the agent was acting within their authority).

Where the agent has acted without the principal's authority, but has nevertheless appeared to act on behalf of a principal, it is open to the principal to decide whether to ratify the transaction or not. If the principal decides to ratify the transaction, they assume the benefits and burdens of the contract from the time the agent acted. The effect of **ratification** is to create **the relationship of principal and agent retrospectively.**

For ratification to be effective, the following conditions **must all** be satisfied or the agent will be personally liable:

- The agent must clearly be acting as an agent.
- The agent must have a known principal in mind. It is not necessary that the principal be named; however, the principal should be capable of being ascertained at the time of making the contract.
- The principal must have contractual capacity at the time of making the contract.
- There should be an act capable of ratification. A contract that is void from its inception cannot be made good by ratification.
- The principal must have full knowledge of all the facts at the time of ratification.
- Ratification must occur within a reasonable time of the contract being entered into.
- Ratification may be express or implied by the conduct of the principal. The only time a special form is required is for the ratification of a deed.
- Ratification must apply to the whole contract.
- Ratification can only be retrospective.

In this case, the conditions all appear to be satisfied (go through them in your answer) and so the unauthorised actions of the agent could be ratified by the principal. A contract existed, as ratification related back to the moment when the contract between the agent

and Lambert was concluded, which was before Lambert's revocation. Lambert's attempted revocation was too late.

Laws sold his hotel to a third party. After the sale, he allowed his name as licensee to continue to be displayed over the front door to the hotel. The persons who bought the business continued to purchase their liquor supplies, as Laws had done, from Tooth & Co on credit. Tooth & Co were not aware of the change of ownership. After several months of the new owners failing to pay their bills, Tooth & Co sued Laws for the cost of the liquor supplied. Who do you think would win – Tooth & Co or Laws? Why?

Again, from the facts you should be able to tell that this is an agency question. In this case, has Laws held himself out as a principal by leaving his name over the door of the hotel? Remember he was the previous owner and by leaving his name as licensee still on the entrance to the hotel, would you think he was still the licensee?

In this case, Laws has a problem. The question is whether there is enough evidence to establish apparent or ostensible authority. In trying to establish apparent or ostensible authority, the courts have been prepared to use **objective evidence**, including:

- the words or conduct of the principal
- custom or trade usage
- situations where the principal has appointed the agent to perform a task that implies a certain amount of authority; and
- whether the position creates an impression of authority.

Laws, by his inaction in not notifying the supplier or removing his name from the sign saying he was the nominee, prevents him from denying that an agency agreement existed. As a result, Laws will be liable to pay for the liquor supplied because, by allowing his name to remain over the front door of the hotel as licensee, he was representing to the public that he was still the owner. Because of Laws's conduct, the rule of evidence called **estoppel** would prohibit him from denying that the purchasers were his agents. Thus, it was possible to infer that the new purchasers were his agent.

Just note that estoppel is a rule of evidence that prevents a person from denying the truth of a statement formerly made by them, or the existence of facts which, by their wording or conduct, have given the impression to others that the statement is true.

Lunghi had a block of land he wished to sell. He approached

Sinclair, a real estate agent, to sell the land for him. Sinclair informed Lunghi that his (Sinclair's) wife was an interested buyer, and after some time, and little buyer interest, Lunghi eventually sold the land to her. Lunghi subsequently discovered that Sinclair's wife was a partner in the real estate agency and that no real attempt had been made to sell the land. It was, in fact, worth substantially more than he was told, and Mrs Sinclair had resold the land for a significant profit. What would you advise Lunghi of his options, if any?

Another problem question. The facts should alert you to the fact that this is an agency situation, so begin by explaining what an agency situation is and that one of the duties of an agent is not to receive a secret commission or make a secret profit.

An agency relationship exists when you (the principal) give your authority to another (an agent) to enter into a contract with a third party which will be enforceable both for and against you (as long as the agent was acting within their authority).

An agent must not make a secret profit, that is, a profit that should have gone to the principal. Where an agent has an interest in a contract, full disclosure should be made to the principal. Were the actions of Mrs Sinclair such that they could be said to amount to a secret profit?

An agent who has a direct or indirect interest in a contract proposed by a principal should make full disclosure. In this case Sinclair was under a duty to disclose the true value of the property and that the profit made by Mrs Sinclair was in fact a secret profit that should go to the principal (Lunghi).

An agent is entitled only to the agreed or customary payment for services performed. An agent must not make a secret profit. In this case, the Sinclair's would be made to account for the profit and would also not be allowed their commission.

Pow appointed McCann & Co, a firm of real estate agents, to sell his flat. Without Pow's knowledge or consent, the agents gave details to a sub-agent, who subsequently sold the property. While McCann & Co were instrumental in arranging the sale, were they entitled to any commission?

Another problem question but one that is much easier to identify as an agency case.

Again, begin by explaining what an agent is and what are the responsibilities of an agent and then apply that you the facts above.

The question to consider here is whether McCann & Co had to act in person or could delegate their authority to a sub-agent. Where a personal confidence or skill is required by the agent, delegation is not possible.

Without Pow's knowledge or consent, the McCann's gave details to a sub-agent, who subsequently sold the property. While McCann & Co were instrumental in arranging the sale, they were not entitled to any commission because Pow's contract with McCann & Co required their personal skill and competence, which could not be delegated.

Harrison, an auctioneer, advertised an auction of horses as being 'without reserve'. This meant that the highest bona fide bidder should have been the successful bidder, whatever the price bid. At the auction, Warlow submitted a bid but the owner of the mare he bid on submitted a final higher bid that the auctioneer accepted. The plaintiff then sued the auctioneer, alleging a breach of the auctioneer's contractual obligation to sell the horse to the highest bona fide bidder. Do you think the plaintiff would be successful in an action against the auctioneer? Explain why.

Another problem question. Here you need to think about the role of the auctioneer and whether he was in breach of his contractual undertaking to sell to the highest bona fide bidder.

Where there is 'no reserve' (the minimum price below which the seller is not prepared to sell), the law is unclear as to whether or not the auctioneer has to accept the highest bid. The bidder cannot sue on the contract of sale because there has been no acceptance, and therefore no contract.

However, there may be a personal action against the auctioneer, as 'without reserve' indicates that the goods or property may be sold to the highest bona fide bidder. The English Court of Exchequer has held that by wrongfully accepting a bid from the owner, the auctioneer was in breach of his contractual undertaking to sell to the highest bona fide bidder. By advertising the auction as 'without reserve', he had undertaken to sell to the highest bona fide bidder—which would be the plaintiff in this case.

VIDEO TRANSCRIPTS AND PDFS

Video transcripts

“What is Negligence?”

Narrator:

In this video we will give you a brief overview of “What is Negligence”?

We see Liam walking down the footpath while he is busy looking down at his mobile phone and wearing his headphones.

We can see a car coming down the road approaching the pedestrian crossing.

The driver of the car has just hit the pedestrian on the crossing. His attention was distracted by a mobile text.

The driver stopped but it was his carelessness that caused the accident. He is under a duty of care to drive carefully and avoid hitting anyone, especially on the pedestrian crossing.

The pedestrian has been injured by the car. He has been placed in an ambulance and is on the way to hospital.

If the injured pedestrian decides to sue, he will now be called the *plaintiff,* and he will sue the driver (now the *defendant)*, for his injuries.

The driver was careless and not paying attention because he was driving while looking at his mobile. This accident was caused by his negligence. Negligence is an *unintentional tort*, that is, a driver does not intend to run down a pedestrian.

Plaintiff’s barrister:

To win a negligence claim, as this is a *civil action*, my client, the plaintiff, must prove on the balance of probabilities, that the defendant owed my client a reasonable duty of care. That is, to drive carefully and not to run him down (particularly on a pedestrian crossing). He has breached his duty of care because he hit my client with his car on a crossing, and my client was injured as a result.

My client must first prove that it is foreseeable that a driver of a car looking at his mobile while driving is being distracted. There is a foreseeable *duty of care* in this matter.

A *reasonable person* driving a car would keep a lookout for other road users (including pedestrians) and could foresee causing injury to a pedestrian crossing the street if he was not paying attention to the road in front of him. From the facts, we would say the defendant breached his duty of care by looking at his mobile while driving and was not as careful as a reasonable person would be.

Finally, we need to consider the issue of *causation*. First, would the injury have occurred 'but for' the defendant's negligent driving? This is a question of fact.

Secondly, did the defendant's use of the mobile distract him and cause the accident? If he had not been looking at his mobile while driving, would there still have been an accident?

If we look at the facts, clearly the acts of the defendant looking at his mobile while driving led to his inattention and the hitting of the plaintiff. Causation would seem to be satisfied.

Judge:

Does the defendant have a defence? From the facts, it appears that the plaintiff was not paying attention to whether it was safe to cross the road as he was busy on his mobile. The law states you have to accept some responsibility for your safety. In this matter the court would probably find the plaintiff contributed to his injuries by not checking if it was safe to cross the road.

The amount of damages in Kina that the plaintiff will be entitled to for his injuries will be determined by what percentage, if any, he was responsible for his injuries. This depends on many factors including looking at his phone while approaching and using the crossing without first checking it was safe to cross. He will also recover damages for pain and suffering, ongoing medical and hospital costs, loss of income and future earnings.

Last slide:

SUMMARY OF NEGLIGENCE

DUTY, and

BREACH OF DUTY, and

CAUSATION, and

DAMAGE

= DAMAGES PGK

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Southern Cross University is committed to publishing high-quality open textbooks which meet the needs of students and educators. This book has been peer-reviewed by one academic subject expert from Universal Business School (UBSS). The full-text was openly reviewed by the reviewer.

The review was structured around considerations of the intended audience of the book and examined the comprehensiveness, accuracy, and relevance of the content. The review was also focused on diversity of perspectives, longevity, clarity, consistency and structure.

The author would like to thank the reviewer for the time, care, and commitment they contributed to the project. We recognise that peer reviewing is a generous act of service on their part. This book would not be the robust, valuable resource that it is were it not for their feedback and input.

Reviewers included:

- Dr Cyril Jankoff EdD, MBA, Grad Dip Tax, BBus (Accy), LLB, Dip Contract Mgt, Cert IV TAE, Fellow CFS, Fellow CPA, Fellow AIMWA, Fellow IML, Fellow World CC and SRME. Associate Professor at Universal Business School of Sydney

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