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Formation of Contracts

Definitions

Consideration

Something that the law treats as valuable, stipulated by the promisor as the price for the promise- what they ask for in exchange for the promise. As a general rule, consideration is essential for the existence of a contract.

Legal capacity

The ability to make a contract. For example, a person lacks contractual capacity until they are 18 years old.

Preconditions that must be satisfied for a promise to be contractual:

- There must be an agreement between the parties containing one or more promises
- Consideration must be provided for those promises
- The parties must intend their agreement to be legally binding
- The parties must have the legal capacity to make a contract
- The agreement must comply with any formalities required by law

Agreement

- 2 elements:
 - A meeting of the minds of the parties (consensus ad idem)
 - At least one promise
- The agreement must be entered into voluntarily. However, whether the parties have reached an agreement is determined objectively not subjectively. This involves making a decision based on the conclusions a reasonable person would draw from the behaviour of the parties.
 - Smith v Hughes 1871 pg 33 (oats)
 - Decided on what a reasonable person would see from the conduct. Must look at the dealings objectively not subjectively. A reasonable person would believe that a contract was made.
- Agreement is only about entering into the contract
- An agreement can exist even though one, or both, of the parties believes that they were obliged to enter or were not happy with the terms and entered reluctantly. (not equal bargaining power)
 - Example: entering into a phone contract. Can't change the terms.

Offer and acceptance

Offer

- An offer is a promise by the offeror to do something or not do something, if the person to whom it is addressed responds in a stipulated manner.
- Any form of words or conduct (usually combination) intentionally communicating this can amount to an offer. For example:
 - Making a bid at an auction
 - Stating a willingness to sell goods in exchange for a price

Acceptance

- An acceptance is an affirmative response to an offer.
- This can be done by literally stating yes although this can be impractical. Thus, unless there is stipulation to the contrary, any form of words or conduct can be an acceptance.

Importance

- Determines whether an agreement has been reached, and when and where. This is usually when and where the offeree's acceptance is communicated to the offeror.

Nature and duration of offers

To whom can an offer be made

- A particular person, a group or the whole world
 - Carlill v Carbolic Smoke Ball Company pg 37
 - Argued that you can't make an offer to the whole world so there is no contract
 - Courts concluded that an offer can be to the world, thus a contract was formed. Anyone who used the smokeball correctly could accept the offer.

Offers distinguished from invitations to deal

- Not every single ad is an offer
- Based upon the intention of the party making the communication.
- A communication is characterised as an offer if the party making it intended that an affirmative response would give rise to an agreement
- If the communication was intended to only initiate negotiation it will be characterised as an invitation to deal.
- Where the offer is clear, definite and explicit and leaves nothing to negotiation, it constitutes an offer. Acceptance of which will complete the contract.
- All about the intention of the parties
 - Displaying goods- Pharmaceutical Society of Great Britain v Boots Cash Chemists pg 38
 - Auctions- AGC (Advances) Ltd v McWhirter
 - Advertisement- Lefkowitz v Great Minneapolis Surplus Store. Where the offer is clear, definite and explicit and leaves nothing to negotiation, it constitutes an offer. Acceptance of which will complete the contract.
 - Bait advertisement- Australian Consumer Law section 35 outlawed it as consumer protection
 - Calls for tender (call for bids)- Blackpool and Fylde Aero Club Ltd v Blackpool Borough Council (the exception)

Offers distinguished from responses to requests for information or statements of possible terms

- Responses to these cannot be an acceptance, and can only be an offer which the other party may accept or reject

Construction and classification of terms

Rules of construction

The basic rule

- The contract is to be given the meaning intended by the parties.
- With few exceptions, intention is determined objectively. As a result, evidence cannot be given of what the parties actually intended, and instead the focus is on their presumed intention.
- Because the courts look at the intention objectively, the courts generally do not want to see evidence of what the parties actual intentions are.
 - *Codelfa Constructions Pty Ltd v State Rail Authority of New South Wales*- when evidence can be used (see below)
 - *Investors Compensation Scheme Ltd v West Bromwich Building Society*- Matrix of facts are what is available to the parties at the time that the contract was made. Excluded from this is previous negotiations as well as negotiations that show their subjective intentions. The meaning of a document that is reasonable to the average person is not the same as the meaning of its words. The meaning of words is a matter of dictionaries and grammar. The meaning will therefore be read by the courts in the context specific to the case.
 - *Royal Botanic Gardens and Domain Trust v South Sydney City Council*

When evidence can be used

- Evidence can be used when the language is ambiguous or there is more than one interpretations of words.
- Evidence cannot be used if it somehow contradicts what is in the contract.
- Facts that are true when the contract is made can be used but only if both parties knew that fact.
- Evidence of prior negotiations can be used but only if it shows that the parties knew the facts. However, cannot be used to show actual intention of parties.

The parole evidence rule

- Deals with the admissibility of extrinsic evidence to determine the terms of the contract. Intended to exclude extrinsic evidence (subjective statements etc)
- If there is a written contract, courts do not to look beyond the actual contract (The four corners rule) because they presume the important stuff is in the contract
- Operates only when the parties intended the document to embody entirely the agreement they have made
 - *Gordon v Macgregor*- "the court must look at the formal deed and the deed alone". To look beyond this, the parties must show that the document was not meant to be the complete embodiment of the contract. Extrinsic evidence can do this. However, extrinsic evidence cannot be used to show what they meant in the terms.

Exceptions to the parole evidence rule

- *Mainieri and Comande v Cirillo*
- The parole evidence rule will not operate:
 1. Where the evidence goes to the validity of the contract (shows there is no binding contract)
 2. Where the evidence shows the true nature of the agreement
 3. Where the evidence establishes a collateral contract
 4. Where the evidence is admitted of surrounding circumstances

Aids to construction (how courts can interpret a contract)

- Words are given their ordinary meaning
- Words are interpreted to promote validity- where one word is ambiguous and one meaning would invalidate the contract but the other meaning wouldn't, the latter is preferred
- Words are not read in isolation- words are read in the context of the document, not in isolation (may show ordinary meaning is not adopted)

- Words are constructed contra proferentem- in cases of ambiguity, a document should be construed against the person responsible for its drafting (especially relevant to exclusion clauses)

Classification of terms

Nature of the term

- Terms may be classified according to their inherent nature: promissory or merely adjectival (regulate aspects of the contract for example jurisdictions of the law)
- Only the former can lead to breach of contract and claim for damages

Nature of the operation

- Terms may be classified by the nature of their operation: whether they operate as conditions precedent (regulates the commencement of the contract or its obligations) or conditions subsequent (providing for the contract, or parts of it, to be brought to an end in specified circumstances)
- Determine whether the parties are contractually bound at all

Importance

- Terms may be classified by their importance: whether they are conditions, warranties or intermediate terms
- Determines what remedies are available
- If a condition, the innocent party will have the option of rescinding the contract and claiming damages or affirming the contract and merely claiming damages
- If the term is a warranty, the innocent party is only able to claim damages (cant rescind)
- If the term is an intermediate one, rescinding will depend on the seriousness of the breach
- Conditions- refers to those terms that are fundamentally important to the contract. Whether the term is a condition or not will depend upon:
 1. Whether it is made a condition by statute
 2. Whether the courts have characterised it as a condition
 3. Whether the parties have made it a condition
 4. Whether it is fundamental to the contract
 - Associated Newspapers Ltd v Banks- questioned whether the changing of cartoon to back page of newspaper was an essential term of the contract as Banks tried to rescind the contract. Was an essential term as it was of "prime importance" to the defendant. Essential term so can rescind contract.
- Test of essentiality- promise is of such importance to the promisee that he would not have entered into the contract if it had not been for that term and this was known to the promisee.
- Warranties- refers to a term of secondary importance so that its breach will not entitle the innocent party to rescind the contract. At term not so important that it touches on an essential matter
- Intermediate terms- has not been, or could not be, classified as a condition or warranty when the contract was made
 - Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd
 - Cehave NV V Bremer Handelsgesellschaft mbH
 - Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd