

CONTRACT LAW

Contract law is a form of private law between individuals and/or companies. It exists in order to provide certainty for parties when they enter into many kinds of agreements, arrangements or transactions with each other. Contracts give parties the opportunity to ask for the assistance of the courts if one party “breaches the contract” by not living up to its end of the bargain. This means, for example, that party A can sue party B if B does not fulfill its obligations under the contract.

CONTRACTS: LEGALLY BINDING PROMISES

Contracts exist in many aspects of our everyday lives and form the backbone of basic business transactions. A contract is a promise between two or more parties (i.e. individuals or businesses) that is legally binding, meaning that there is a legal obligation to keep the promise. The promises that the parties make are called the terms of the contract and they describe each party’s rights (i.e. what a party is entitled to from the other party) and obligations (i.e. what a party is required to do) according to the contract. Contract law sets out the principles that determine whether an agreement is actually a legally binding contract between parties. This is important because while all contracts are agreements, not all agreements are contracts. Contracts, in a legal sense, only exist and are enforceable when certain requirements have been met.

TYPES OF CONTRACTS

Contracts cover a very broad range of relationships between members of society. For this reason, it is helpful to think of two main types of contracts:

- those defined by *how many parties* are making promises in the contract, and
- those defined by the *type of communication* used to form the contract.

1. Number of Parties: Bilateral and Unilateral Contracts

As their names imply, bilateral and unilateral contracts differ from one another in that the offers and promises made are either one-sided or two-sided.

Bilateral contracts involve a promise being exchanged for another promise. Two parties agree on specific terms about what will be exchanged for what, and then carry out their respective obligations. For example, an employment contract is a type of bilateral agreement because the employee agrees to work in exchange for a specific amount of compensation.

Unilateral contracts, in contrast, involve a promise made by a single party in exchange for some kind of action (i.e. performance) by an unknown party. For example, imagine that a person loses a necklace and then offers a reward to any person who returns that necklace. The owner of the necklace is creating a unilateral contract. When

someone returns the lost necklace, that person is considered to have performed the act, completing the contract, and the owner would be required to give the finder the reward that was offered. The key difference between a unilateral and bilateral contract is that here, only the person offering the payment is making an explicit promise.

2. Type of Communication: Oral, Written and Implied Contracts

Oral and Written Contracts – All of the terms of a contract should be clearly understood by the parties involved. Usually, these terms can be negotiated and finalized either in writing or orally. There are laws that require certain types of contracts to be written, but these only apply in very specific situations such as the purchase or sale of a house. A handshake agreement could be considered an oral contract that is binding on the parties and enforceable through the courts.

Implied Contracts – Not all contractual relationships require the exchange of words or the negotiation of terms. Contracts in which the parties' mutual understanding of the terms is expressed by their actions instead of their words are known as implied contracts. For example, purchasing a drink at the convenience store involves the customer making a contract with the store. The customer gives the store money in exchange for the drink. Typically, the parties do not have a conversation to determine what drink will be exchanged for what price and they certainly do not sit down and draw up a complex agreement in writing. Instead, the contract is implied by the actions of the parties.

BUILDING BLOCKS OF A CONTRACT

In order for an agreement to be considered a legal contract, there are some essential elements that must be present. There must be an intention to contract, an offer to contract and an acceptance of that offer, and consideration. In addition, the terms of the contract must be clear in order to be enforceable by a court.

- 1. Intention to contract** – In order for a contract to be legal, the parties must have intended to create a legally binding relationship. A court will not, for example, enforce a casual agreement between two people who agree to go shopping at 3PM because there was no intention to have a legally binding contract. However, where the parties are entering into a business transaction, it may be easy to demonstrate that such an intention existed.
- 2. Offer and Acceptance** – An offer is an invitation to enter into a contract. The offer outlines the terms of the contract and is made with the intention that it will become a binding agreement once accepted by the person to whom it was addressed. An acceptance of an offer is when the other party accepts the offer to contract.
- 3. Consideration** – Consideration is when something of value is promised by one party to the other when making a contract.
- 4. Certainty of terms** – A valid contract must have clear terms that make sense to both parties. They must also be certain enough to be interpreted by a court should they need to be enforced.

INTENTION TO CONTRACT

An agreement is enforceable only when the parties intend to create a legally binding relationship. Not all agreements are made with this intention, so a court would need to consider the nature of the relationship between the parties and any evidence about the formation of the agreement in order to determine if the parties did intend to contract with one another.

Family Relationships

The general rule in law is that where there is a sufficiently close relationship between the parties, such as between family members, spouses or close friends, there is a presumption that the parties do not intend for their promises to be legally binding agreements. This presumption can, however, be rebutted if one of the parties wants to show that despite the close nature of the relationship, they intended to create a legally binding contract. In determining whether there was an intention to create a legal contract, a court will consider several factors, such as whether the agreement was written, if lawyers were involved in drafting the agreement, whether one party relied on the presumption of a contract to their detriment, and what the actual nature of the relationship is as opposed to its formal title, among others.

For example, in the English case of *Merritt v Merritt* (1970),² Mr. and Mrs. Merritt signed a written agreement upon separation stating that if Mrs. Merritt continued to pay the mortgage on their home, that once the

mortgage was paid in full Mr. Merritt would transfer the property to her. When that time came, Mr. Merritt refused to transfer the title and argued that he had no intention to create a legally binding contract with his former wife. The court ruled that there was in fact a contract and ordered Mr. Merritt to transfer the deed for the home to Mrs. Merritt. Despite the family relationship, Mrs. Merritt was able to provide evidence that the parties intended to contract and therefore the presumption was rebutted.

Commercial Relationships

Conversely, parties entering into contracts in business settings are presumed to intend for their bargains to be legally binding contracts. Once again, this presumption can be rebutted if the party wanting to disprove the contract shows evidence that despite the nature of the relationship, there was no intention to create a legally binding relationship. For example, if the person could show that there was a clause in the contract indicating that “this is not a formal legal agreement”, the court may consider the presumption to have been rebutted.

OFFER AND ACCEPTANCE

In order for a contract to be enforceable, the parties involved must have a mutual understanding of the terms of the agreement. This shared understanding, often described as a “meeting of the minds,” has two distinct elements: the **offer** and the **acceptance**.

- An **offer** is a direct and purposeful act in which one party approaches another with the intention of forming a contract. The

² *Merritt v Merritt* [1970] EWCA Civ 6 (27 April 1970)

offer should clearly indicate the terms of the contract. The way in which the offer is communicated can take on a wide variety of forms; the key question is how clearly all the terms of the offer are expressed. Sometimes, courts are called upon to judge whether these terms were adequately clear in the offer.

- The **acceptance** is an equally clear, direct and purposeful response to an offer that signals that the accepting party agrees to the terms that were laid out in the offer, and wishes to form a legally binding contract under that arrangement.

This forms the basis for the meeting of the minds. Note, however, that there are a variety of reasons for which either an offer or an acceptance may be found invalid in court, if one party challenges the contract. Offers, for example, can expire after a reasonable time period has passed, even if an expiration date is not specified. Consider the “lost necklace” scenario mentioned earlier. If a person attempted to claim the reward for that necklace 50 years after the reward was offered, the courts would likely not enforce the contract because an unreasonable amount of time had passed.

Similarly, there are circumstances where a court may find an acceptance to be invalid. Among other considerations, the acceptance is only valid where:

- The offer is still open for acceptance;
- The acceptance is under the same terms as the original offer. If the acceptance is for different terms, it may be constitute a

counter-offer rather than an acceptance of the original offer.

- It is communicated expressly (i.e. in words or writing) or by other conduct that clearly shows you have accepted the offer; and
- It is accepted by the person to whom the offer was made, or a person authorized to accept it on that person’s behalf.

CONSIDERATION

A contract represents the exchange of promises, in which each party promises something to the other. In that sense, each party is both a promisee and a promisor, even though the promise each makes may be different. What each person promises the other is known as the “consideration”, and each party must give consideration for a contract to be valid. In law, the general rule is:

1. that the person who makes the promise has to **get a benefit** for the making of the promise, OR
2. the person to whom the promise is made has to **experience some detriment** (i.e. loss or disadvantage) at the request of the promisor.

In short, consideration is something of value given by both parties to a contract that induces them to enter into the agreement. For example, if Juan promises Angela \$300 to paint his house, the consideration provided to Juan is the promise to paint the house and the consideration provided to Angela is the promise of \$300. This transfer is required

because the heart of contract law is the concept of a “bargain.” It would not make sense for a party to enter into a legally binding agreement for nothing. While money is often the consideration that lies at the heart of contracts, that is not always the case. People can exchange favours, items or even make agreements on the promise of one party to refrain from doing something. For example, in the case of *Hubbs v Black*³ (1919) agreeing not to take a certain plot in a cemetery was found by the court to be sufficient consideration to form a legally binding contract.

CERTAINTY OF TERMS

In order for a contract to be valid and enforceable, its terms must be clear and complete such that both contracting parties understand their meaning. Contracts may be uncertain if key information in the terms is ambiguous and could have multiple meanings, or if it is not specific enough. For example, a contract for the sale of a boat might not indicate which boat is being sold, and if there are many boats matching the description for sale in the harbour, it could create a situation of uncertainty. Contracts may also be deemed incomplete if the terms fail to specify certain obligations under the contract, or if important information is missing from the terms. For example, a contract for the sale of goods may be considered incomplete if it fails to specify the price, quantity or delivery date of the goods.

In situations where a contract has uncertain or incomplete terms, courts will attempt to interpret the terms of the contract by first looking at the language of the document itself and trying to determine the meaning. If ambiguity remains after looking within ‘the four corners of the contract’, a court will then consider other factors to determine what the parties intended their agreement to be. Such considerations may include the past dealings between the parties, relevant industry standards and any communication between the parties before coming to an agreement. It is important to note, however, that courts will not work out the terms of the agreement if there is not enough information to guide them. Courts will not create entire contracts for parties. In situations where the court cannot determine the terms of a contract, the contract will fail either in whole or in part (i.e. the uncertain or incomplete terms will be invalid) and it will be unenforceable.

ENFORCEABILITY OF CONTRACTS

Not all contracts, even if validly formed, will be enforced by the courts. While the basic direction taken by the courts in Canada is that they should seek to uphold contracts because of their importance to society, there are certain circumstances where the courts will not enforce a contract. Some of these circumstances are outlined below:

³ *Hubbs v Black* [1919], 46 DLR 583, [1918] OJ No 48 (Ont SC App Div)

LACK OF CAPACITY TO CONTRACT

With respect to contract law, capacity refers to a party's ability to understand the terms, meaning and consequences of entering into a contract. The courts seek to protect people who may lack capacity, such as minors (i.e. people under 18 years old) and people with intellectual or developmental disabilities, from being taken advantage of by unfair contracts. Generally speaking, both of these groups are deemed to lack the capacity to enter into contracts.

Minors

The general principle is that a contract made by a minor with an adult is binding on the adult but not on the minor, including when the person reaches the age of majority. However, if at the time the person reaches age of majority, they confirm the promise they made as a minor or act consistently with the terms of the contract, it may become binding. There are some notable exceptions to this rule, however. Some contracts that minors enter into can be enforced if they involve goods that are life necessities, or are entered into solely for the benefit of the child.

- **Necessaries** – According to s. 3 of the *Sale of Goods Act, 1990*⁴, minors are legally bound to pay for necessities supplied to them under a contract. "Necessaries" are things that a person cannot reasonably exist without, including food, clothing, lodging, education or training in a trade,

and essential services. The necessities of one minor will not necessarily be the same for another, depending on their age and immediate needs. For example, in *Nash v Inman*⁵ (1908), a tailor supplied clothing to a minor who then refused to pay. The tailor sued, claiming that the clothes were "necessaries" under the *Sale of Goods Act* and therefore the minor should be required to pay a reasonable price. The Court ruled in favour of the minor, holding that for this particular person, these were not considered "necessaries" since he already owned adequate clothing. The offer was made, or a person authorized to accept it on that person's behalf.

- **Beneficial contracts of service** – The law allows a minor to enter into an employment contract where the minor is exchanging their services for compensation, provided that the contract, taken as a whole, is beneficial to the minor for the entire duration of the contract.

Mental Incapacity

A court may find that an individual lacks the capacity to contract on a permanent basis based on a mental illness or disability that prevents them from understanding the terms, meaning and consequences of entering into a contract. A person may also be found to lack capacity to contract on a temporary basis due to intoxication if it were to a level that the person's ability to appreciate the nature of the contract was impaired.

⁴ *Sale of Goods Act, RSO 1990, c S 3*: http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90s01_e.htm#BK3

⁵ *Nash v Inman* [1908] 2 KB 1, CA

DEFECTS IN CONTRACTUAL RELATIONS

Additional circumstances are outlined below where the courts will not enforce a contract.

Misrepresentation

Misrepresentation occurs when one party convinces another to enter an agreement under false pretences. For example, if A sells a car to B representing that the car has a certain number of kilometres and is in a certain condition when in fact it is not, B could argue that A misrepresented the condition of the car and that the contract should be set aside.

Mistake

This is similar to misrepresentation, but without the intentional misleading of one of the parties by another. Contracts may be nullified due to mistake if one of the parties had a genuine misunderstanding or false belief about key terms of the contract. For example, if A has a painting and genuinely believes it to be an original work of a famous artist and sells it to B, who later finds it is a fake, the courts can nullify the contract on B's behalf. However, due to the potential for abuse, the courts apply elaborate legal precedents to determine whether each party's beliefs were, indeed, genuine.

Frustration

Sometimes contracts cannot be carried out for reasons that are not the fault of either party. For example, if A hires B as a ballet performer, but B gets injured and can no longer dance, the courts will not enforce A's claim against B for breach of contract.

Illegality

Contracts that are formed or carried out for illegal purposes will not be enforced. For example, if A pays B to steal from C, but B does not do so, A cannot sue B for breach of contract. However, not every contract that involves an illegality is unenforceable. If A hires B's delivery service to send a package, and B breaks the speed limit while doing so, A cannot argue that the contract is invalid because of B's violation. Matters like this are often left to the discretion of the courts. Notably, the courts may also refuse to enforce contracts in situations when they deem that doing so would be contrary to public policy or against the general morality of the community. For example, contracts between sex workers and clients are not enforced, even though prostitution is not illegal. Similarly, a contract between businesses that unduly restricts competition by fixing the price of goods should not be enforced.

Duress, Undue Influence and Unconscionability

In each of these circumstances, the contracts would be unenforceable due to an unfair power imbalance that induced one of the parties to enter into a contract.

- **Duress** – Where one of the parties used physical violence or threats to get the other party to enter into the contract.
- **Undue Influence** – Where someone in a special relationship based on trust and confidence exploits that relationship to induce someone to enter into a contract. This can include relationships of trust with

clergy, doctors, parents, spouses and anyone owing a fiduciary responsibility to another.

- **Unconscionability** – Where there is no threat of physical violence and no special relationship of trust, a contract can still be set aside where a party with greater power induces a weaker party into an unfair bargain.

REMEDIES

If one party is found to be in breach of a contract, the court can order any of the following remedies:

DAMAGES

Damages are an award of money to compensate the innocent party. This is one of the most common remedies for breach of contract. The general principle of damages is to place the injured party in the position they would have been in had the contract been performed.

When damages are not appropriate because, for example, it is impossible to calculate the monetary value of the damages, the court has a number of other equitable remedies available.

SPECIFIC PERFORMANCE

The court may order that the party in breach actually perform the contract as they were supposed to do. Specific performance is usually used to enforce the positive covenants of a contract, or those that require a person to take action.

INJUNCTION

Similarly, a court may order a party not to breach the terms of the contract. Unlike specific performance, injunctions are usually ordered to enforce negative covenants of a contract where a party agrees not to do something. For example, if an actress agrees to perform exclusively for a particular movie studio and then begins taking roles with other studios, the court may order an injunction to prevent the person from acting in other productions for a period of time.

RESCISSION

In some circumstances, a court may order that a contract be cancelled completely. The goal is to place the parties back in the position they were in before they entered into the contract. Rescission is a remedy often used where a contract is found to be void, such as in cases of misrepresentation, mistake, duress, undue influence or unconscionability.

DISCUSSION QUESTIONS

1. What is the main difference between a promise and a contract?
2. Trey's dog is sick so he takes her to the vet for treatment. The vet examines and treats the dog and she recovers fully. Trey is billed for the specific treatments and pays the vet \$200. What type of contract is this arrangement? What consideration was given by each party?
3. Gurpreet and Anya are sisters. Anya has just been accepted into law school but is worried about how she will pay her expenses. They make an oral agreement over coffee one day that Gurpreet will pay Anya \$300 per month in order to help with her school expenses. Halfway through the year, Gurpreet decides that she would like to start saving for a down payment for a house and she tells Anya that she will no longer provide her the \$300 per month. Anya is considering suing for breach of contract. How likely is it that the agreement will be enforced by the courts? If it seems unlikely, what could have Anya done to ensure their bargain was legally binding?

4. a) Efraim and Keiko make a bargain with one another that each of them will give Marla \$10. Review the general rule about consideration and determine whether there is sufficient consideration for this mutual promise to be a legal contract.

b) If Efraim and Keiko mutually promise to abandon their agreement, can Marla sue them for breach of contract? Why or why not?

5. If a contract between two companies who often do business together includes ambiguous language that the parties cannot agree on the meaning of, what kind of other information could a court use to determine what the parties meant?

6. Hector agrees to sell Angel a number of shirts, but prior to delivery the shirts are destroyed in an accidental fire. Will the courts enforce this contract? Why or why not?

7. Hans, who had recently suffered a stroke, met with a local farmer named Leo who was interested in buying his land. Hans agreed to sell the land for \$70 000, a price under market value, and signed a draft agreement of purchase with Leo. Two months later, Hans passed away. When his children learned of the sale of the land, they initiated a law suit against Leo on behalf of Hans' estate. Will the courts enforce this contract? Why or why not? If not, what do you think would be an appropriate remedy?

8. Think of a time in your own life where there was an exchange of promises. Which of the elements of a contract were present? What consideration was involved? Were there any contractual defects that would make the contract unenforceable? If one party breached the contract, what would be an appropriate remedy?

CASE STUDY 1 - *Carlill v Carbolic Smoke Ball Company (1893)*⁶

In nineteenth-century England, a company created a device called the “Carbolic Smoke Ball” that claimed to fight influenza. The manufacturer advertised that buyers who found that it did not work would get £100. The specific language of the advertisement was:

“£100 reward will be paid by the Carbolic Smoke Ball Company to any person who contracts the increasing epidemic influenza colds, or any disease caused by taking cold, after having used the ball three times daily for two weeks, according to the printed directions supplied with each ball. £1000 is deposited with the Alliance Bank, Regent Street, showing our sincerity in the matter. During the last epidemic of influenza many thousand carbolic smoke balls were sold as preventives against this disease, and in no ascertained case was the disease contracted by those using the carbolic smoke ball.”

Louisa Carlill saw the advertisement, bought one of the balls and used it three times daily for nearly two months until she contracted the flu. When Ms. Carlill tried to claim her £100 from the Carbolic Smoke Ball Company, they refused to pay her. She brought an action against the company, arguing that the advertisement and her reliance on it was a contract between her and the company. The company argued it was not a serious contract.

1) What contractual issues come up in this case?

2) Is this contract valid? Why or why not?

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Issue

Are all of the elements of a contract present in order for this to be considered a legally binding agreement (i.e. intention, offer and acceptance, and consideration)?

Decision:

The Court held that all of the essential elements of a legal contract were present, including intention to contract, offer and acceptance, and consideration. The Court presumed that this was a business relationship and there was an intention to contract, holding that the specific language and the deposit in the bank account were sufficient evidence that the company did intend to enter into a legally binding relationship with any person who accepted their offer. The court ruled that the advertisement itself was an offer to contract and that Ms. Carlill accepted the offer when she performed the conditions of the offer (i.e. used the ball three times daily for two weeks). The purchasing and using of the smoke ball constituted good consideration because it was a detriment to the promisee (i.e. Ms. Carlill) at the request of the promisor (i.e. Carbolic Smoke Ball Company).

⁶ *Carlill v. Carbolic Smoke Ball Co.* [1893] Q.B. 256 (C.A.)

CASE STUDY 2 -

*Toronto Marlboros Junior A Hockey Club v Tonelli (1979)*⁷

At the age of 16, John Tonelli signed a minor league contract to play for the Toronto Marlboros Junior A Hockey Club. His contract stipulated that he would have to play for the team until he was 20 years old and also contained a clause stipulating that if he joined a professional team, he would have to pay the Marlboros 20% of his earnings for the first few years. In exchange, the team, would groom him to become a professional player. Tonelli played well and got the attention of professional scouts. When he turned 18, he cancelled his existing contract and signed with a professional team in a higher league. The Marlboros sued him for breach of contract.

1) What contractual issues come up in this case?

2) Is this contract valid? Why or why not?

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Issue

Is Tonelli legally bound by a contract he signed when he was a minor?

Decision:

The court ruled that the contract was not binding on Tonelli and that he had a right to terminate it. When a contract is for a minor's services, the contract is valid only if it is beneficial to the minor for the full duration of the contract and its benefit is clearly apparent. In this case, the contract was longer beneficial to Tonelli once he was offered the chance to play for a professional team. Tonelli went on to have an outstanding career in the National Hockey League, where he won four Stanley Cups with the New York Islanders.

⁷ *Toronto Marlboros Major Junior "A" Hockey Club v Tonelli et al* [1979] 23 OR (2d) 193