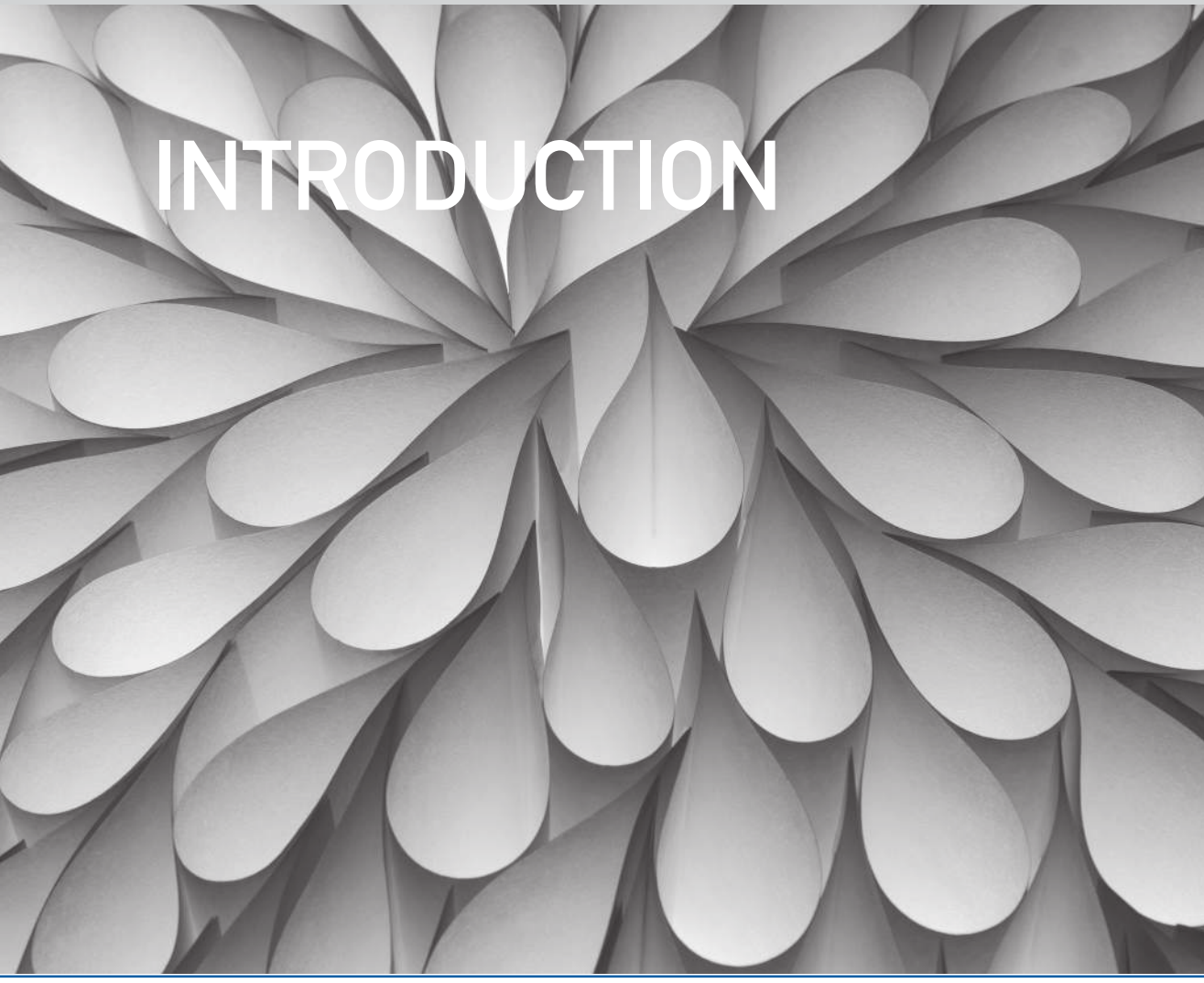
PART



INTRODUCTION

1

SOME BASIC QUESTIONS

What is a contract?

1.01 The prevalence of contracts

We make contracts all the time, even if we don't realise or think about it; for instance, when we buy a cup of coffee, or get on a bus or train, or use a commercial car park. There is a tendency to think about contracts as written or printed documents.[1] Ask an employee if they have a contract, and they'll usually answer 'yes' only if they can remember signing some sort of formal agreement. But, in fact, *every* employee has a contract. Merely agreeing to work in return for wages constitutes a contract in the eyes of the law, even if all the arrangements were made verbally and there is little, if any, documentation of the terms of the job. The same is true for many other everyday transactions. If you buy something, or agree to pay money for a service (such as being transported somewhere, or having your property looked after), you are generally making a contract. Certain types of contract have to be recorded in writing to be legally enforceable; for example, an agreement to buy and sell land. But those types are very much the exception, not the rule: see **5.44**.

If contracts are important to individual consumers, they are absolutely central to the operation of any business. Most commercial enterprises will, at some point, acquire premises and/or a website, secure finance, open a bank account, purchase supplies, employ staff, insure against certain risks or losses – and, of course, agree to supply goods or services to their clients. Once again, all of those transactions involve contracts.

Contracts are not quite all-pervasive. There are some transactions that, for reasons explored below, the law does not recognise as involving a contract. And, in at least one major instance, Australian law has stopped treating a type of agreement as being contractual in nature: that being an arrangement to get married. It used to be possible to sue your fiancé(e) for 'breach of promise' if they failed to honour an engagement to marry, but that type of action was abolished in Australia by legislation in 1976.[2] In other respects, however, contracts are on the rise. In the government sector, for instance, many arrangements or relationships are now recognised as having a contractual basis – even if there remain important exceptions.[3]

1.02 A rough definition

So what then is a *contract*? The word can be used in many ways or contexts; consider, for example, the notion of a 'social contract' in political philosophy, or the 'psychological contract' that is said to lie at the heart of modern employment relations.[4] But in a book of this kind, we are using the term in its legal sense. Even then, it is hard to give an answer that is both accurate and concise. A rough definition would be this: an *agreement* between two or more *parties*, involving one or more *promises* that are *given for something in return*, and that the parties *intend to be legally enforceable*.

1 See eg Wilkinson-Ryan & Hoffman 2015, presenting empirical evidence that most individuals associate contracts with some kind of *formalised* agreement.
2 See *Marriage Act 1961* (Cth) s 111A, inserted by the *Marriage Amendment Act 1976* (Cth).
3 See Seddon 2018: ch 1; and see further **5.07**.
4 See eg Rousseau 1762; Rousseau 1995. It is a striking coincidence that the authors of leading works in these very different fields should happen to share the same surname!

More is said about the requirements for contract formation in Chapter 5. But for now, three elements of this definition are worth exploring in a little more detail: the concept of being a 'party' to a contract; the significance of legal enforceability and how we know when it is intended; and the requirement that a contract involve some kind of exchange.

1.03 The parties to a contract

The term *party* will be used a lot in this book, generally to mean a person who has made a contract with someone else. The 'person' concerned may be an individual, or an artificial entity (such as a corporation or a state) that the law treats as if it were a person. Corporations or governments can enter into legally binding agreements, even though they necessarily have to act through the agency of human beings.[5]

In practice, the vast majority of contracts are made between two parties (buyer and seller, landlord and tenant, employer and employee, etc). Most of the book is written on that assumption; for instance, by referring to 'both parties', 'the other party', and so on. But it is certainly possible to make a contract with more than two parties, as Chapter 8 will explain. That chapter also explores the legal position of a *third party*. Confusingly, this term generally denotes a person who is *not* a party to a particular contract, but who is affected by it or connected to it in some way. As will be seen, the general rule in Australia is that a third party cannot enforce a contract, nor can it be enforced against them. This is true even if the parties to the contract intended to confer a benefit or an obligation on that person. This principle is known as the doctrine of *privity of contract*.

To take a simple example, suppose a manufacturer makes a batch of electrical goods and sells them to a distributor. The distributor sells some of them to a retailer. The retailer sells one of these items (say, a toaster) to you. What we have here is a chain of contracts, with different parties to each. If the toaster doesn't work, you may be able to sue the retailer for *breach of contract* (that is, for failing to comply with a contractual obligation), for reasons explained in Chapter 9. But you, the consumer, cannot sue the manufacturer on that basis, because, in this case, you are not party (or 'privy') to any contract with that business.[6] This is not to say you have no remedy at all. You may, for example, be able to sue the manufacturer for committing the *tort* (a civil wrong) of negligence, or for breaching Part 3–5 of the Australian Consumer Law (ACL).[7] But there can be no claim under the law of contract.

1.04 The intention for an agreement to be legally enforceable

Not all agreements are contracts. For example, if two friends agree to meet for dinner, that is just a social arrangement. It would be absurd to suppose that if one didn't show up, the other could take them to court and sue for breach of contract. It would be understood that the arrangement was not one that was *intended* to carry legal consequences.

5 As to the power of an agent to enter into a contract on behalf of their 'principal', see further **8.04**.
6 But compare the famous case of *Carlill v Carbolic Smoke Ball* (1893), where a contract *was* found to exist between a manufacturer and a consumer: see **5.06**.
7 See Luntz et al 2017: 427–31, 847–56. As to the ACL, see **1.15**.

Contracts are a form of private law-making. Many laws are imposed by the state, in the form of prohibitions and commandments. Depending on how they are framed, these norms of conduct may be enforced either through the criminal justice system (where the state itself pursues sanctions against a law-breaker), or through civil proceedings (where one member of society asks a court to impose remedies against another).[8] But our legal system also allows citizens and organisations to voluntarily assume obligations that can be enforced by the state's legal apparatus. There are a number of ways in which this can happen. For example, one or more persons may create a *trust* – an arrangement that requires specified property to be held by one person and dealt with for the benefit of another: see **8.14**. But the most common way in which legal obligations are privately created is through the making of a contract. As the High Court of Australia put it in *Australian Woollen Mills v Commonwealth* (1954) at 457: 'It is of the essence of contract, regarded as a class of obligations, that there is a voluntary assumption of a legally enforceable duty.'[9]

So how do we know whether, in making an agreement, the parties do in fact intend that a failure to comply with the agreement may lead to a civil action for breach of contract? What if the issue was never discussed? In theory, this might present a problem; but in practice it generally doesn't. This is because an intention for an agreement to be enforceable can often be inferred, simply from the nature of the transaction. If you agree to buy, sell or hire something, or to work in return for some form of payment, it can be assumed that you and the other party intended the arrangement to be legally binding, unless there is something in your dealings to suggest otherwise. Conversely, if you make some kind of arrangement with a family member or friend, especially of a non-commercial kind, the courts are less likely to identify an intention to make a contract (or an *intention to create legal relations*, as it is often put). More is said about this in Chapter 5.

If there is a problem with intention that tends to crop up in practice, it is in determining *at what point* the parties have formulated an agreement they intend to be legally binding. It is not uncommon for parties to arrive at a tentative or preliminary agreement, while contemplating either some further process of negotiation, or the need for some condition to be satisfied, before the arrangement is finalised. The status and enforceability of such preliminary agreements is considered in Chapter 6.

It is also important to understand that contractual intention is usually assessed *objectively*. A court does not usually ask what the parties actually or *subjectively* intended. Rather, the question is what a reasonable person would believe they had in mind: see **5.02–5.03**, **10.02**.

1.05 Contract as exchange

In some legal systems, a promise to do something may become legally enforceable even if it is *gratuitous* – that is, given with no expectation or insistence that the *promisor* (the person making the promise) will receive anything in return from the *promisee* (the person to whom it

8 The line between criminal and civil liability has been significantly blurred in recent years by the rise of regulatory regimes that allow government agencies to seek what are described as civil remedies (including monetary fines) for breaches of statutory requirements: see eg *Commonwealth v Director, Fair Work Building Industry Inspectorate* (2015); and see further **3.16**.

9 For analysis of what it means to speak of a contract as a *voluntary* act, see Robertson 2005.

is made). For example, under the 'civil law' systems that predominate in Europe, it is generally sufficient that the reason (*causa*) for making the promise is a serious or significant one.[10]

Under Australian law, by contrast, a gratuitous promise cannot be the basis for a contract. This is one of the many principles that we inherited from the English common law: that a contract must involve (or, as it is sometimes said, be 'supported by') *consideration*. In this context, 'consideration' is a technical term that packs a lot of legal meaning into a single word. It denotes a requirement of bargain or exchange – or as the Latin phrase puts it, *quid pro quo*. What one party is promising to do must be in return for something that the other party is doing or promising to do. So, if you promise to give someone a car, that is just a gift, a gratuitous promise. But if you promise to give someone a car *in return* for them promising to give you some money, that element of reciprocity satisfies the requirement of consideration: you have made a contract of sale. That is true even if nothing has yet been done to fulfil those promises. An exchange of commitments is sufficient.

The doctrine of consideration also requires that what each party is doing or promising to do must have 'value'. Normally, that requirement is easily satisfied – especially as the law does not generally require that what is given represent fair or 'adequate' value. So in the example just given, both the car and the promised sum of money will be treated as 'good consideration' – even if the sum in question represents far less than the car might be worth to other purchasers. But, as will be explained in Chapter 5, there are also some highly technical rules as to what constitutes 'valuable consideration'. Some commitments are treated as 'insufficient' to constitute good consideration; for instance, promising to do something that you are already obliged to do.

While the requirement of consideration means that gratuitous promises cannot be legally enforced, there are at least two important exceptions. The first is that any promise will be rendered enforceable, even in the absence of consideration, if it is expressed in a formal document known as a *deed*: see **5.47**. The second stems from the operation of a doctrine known as *estoppel*. In some cases at least, as Chapter 7 will explain, this may allow a promisee to go to court and hold a promisor to their commitment, where the promisee has relied on the promise to their detriment.

1.06 Bilateral and unilateral contracts

The overwhelming majority of contracts are *bilateral* in nature; that is, they involve each party promising to do something for the other.[11] A vendor promises to deliver goods or hand over the title to land, in return for the purchaser agreeing to pay for the property they are acquiring. A landlord agrees to give temporary possession of land or premises, in exchange for the tenant undertaking to pay rent. An employee promises to provide their labour, on the

10 As to the distinction between *causa* and the common law notion of 'consideration' discussed below, see eg Lorenzen 1919. Interestingly, a recent package of reforms intended to modernise French contract law has abolished the *causa* requirement: see *Ordinance No 2016–131*; and for background, see Rowan 2017: 816–18.

11 Some judges use the term 'synallagmatic' in preference to bilateral: see eg *Hong Kong Fir Shipping v Kawasaki Kisen Kaisha* (1962) at 65. But compare *Simic v New South Wales Land and Housing* (2016) at [16], [36], highlighting the term's origin in civil law systems to refer to a particular type of what common lawyers would call a 'bilateral contract'.

basis that the employer will pay them for their work. In each of these and many other similar cases, there is generally a moment (no matter how brief) where the parties' agreement is wholly *executory*; that is, they have exchanged promises, but are yet to fulfil them. To put it another way, when a bilateral contract is made, both parties typically assume an obligation to do something they have not yet done.

With a small minority of contracts, however, the obligation is only ever on one side: these are called *unilateral* contracts. One party promises to do something, if the other party satisfies some condition that they *may* fulfil, but are not *bound* to fulfil. The classic example is a reward. You promise someone a sum of money if they supply you with certain information (say, the whereabouts of your missing cat, or the identity of someone who has committed a criminal offence), which they may or may not be able to do, and are not promising to do. If the promisee fails to supply the information, you cannot sue them for breach of contract. Indeed there *is* no contract – unless and until the promisee performs the act you have requested. If they do so, that provides the consideration for your executory promise and you now become obliged to fulfil it. But at no point is the promisee under any obligation to perform. More is said about unilateral contracts and some of the legal issues they raise in Chapter 5. But it is worth emphasising that in practice they are very much the exception rather than the rule.

Why should promises be enforced?

1.07 Moral explanations

In Chapter 2 we briefly survey some of the large body of literature on the theoretical underpinnings of contract law. Some of that literature seeks to explain the enforceability of contracts by reference to what are essentially *moral* considerations. These include the *ethical imperative* to keep a promise, a recognition that the parties to a transaction have *consented* to the imposition of legal obligations, or the need to protect a person whose *reliance* on a promise being kept has caused them to act in a particular way.

The problem with many of these theories, however, is their limited descriptive force – they struggle to explain some of the rules of modern contract law. They have also, for the most part, been developed well after the 'classical' period in the nineteenth century when, as described below, many of those rules crystallised into something like their current form. The key lawmakers of that period may conceivably have had a fully formed set of ideas that underlay the principles they were helping to formulate. But if they did, it was rare for them to be mentioned or explained.[12]

1.08 A practical perspective: security, specification and risk allocation

At the risk of being accused of oversimplification, it seems to us that the main reason that what we now describe as 'contractual' promises are considered to be legally enforceable is a simple one. If they were not, the trade in property, services and credit that has

12 See further **2.05** concerning the influences on, and limitations of, 'classical' contract theory.

become central to modern societies would, if not break down entirely, at least have to operate in a very different fashion.[13]

Contracts arguably perform at least three key functions in relation to commercial dealings. The first is to *secure supply*; that is, to bolster the expectation that what one party has promised, the other will in fact receive. One of the most influential modern writers on contract law, Hugh Collins, notes that some markets have been shown to function effectively even without state enforcement. And even where there is a legal apparatus available to enforce promises, the trust that one party places in the other to fulfil their commitments may play at least as important a role in inducing transactions as the sanctions notionally available in the event of non-performance. Furthermore, non-legal sanctions (such as the threat of refusing to transact in the future, or of inflicting reputational damage) are in practice used far more commonly than litigation.[14] All these points may be accepted. Yet it is still hard to believe that individuals and organisations could or would deal with one another in the same way without at least an *assumption* that their contracts could, if necessary, be legally enforced. This is a point that obviously takes on greater significance in relation to certain types of market, such as banking and financial services. The same applies to transactions involving large sums of money or between parties with low levels of trust.

A second function is to *specify* what has and has not been agreed. A failure to do this in relation to what are considered the 'essential' terms for a given type of transaction may render an agreement unenforceable, on the basis that it is 'incomplete': see **5.36**, **5.38**. As noted there, however, courts are often willing to imply terms to fill what would otherwise be significant gaps in what has been agreed.

A third important function of contracts is to *manage risk*. Besides stipulating any benefits to be conferred or tasks undertaken, the parties may agree on how certain eventualities are to be handled. These may relate to the parties themselves (such as a failure to meet a specified standard of performance, or a desire to vary or end the arrangement), or to matters outside their control (such as the unavailability of key supplies or finance, or a change in market conditions). The use of 'exemption clauses' to exempt or limit a party's liability for breach of contract or other wrongdoing is merely one example of such explicit risk allocation. Some transactions are indeed entered into with the primary purpose of managing a particular risk, such as an insurance contract or a contract of guarantee. Each of these types of arrangement are discussed in Chapter 11.

The fact that we are presenting here what might be seen as an *economic* explanation for the making and enforcement of contracts does not mean that we accept everything that has been written by way of economic analysis of contract law. For one thing, much of that writing is normative rather than positive: it is concerned with what the law *ought* to provide, as opposed to explaining or justifying its current rules. For another, as we note in **2.17**, there are very different strands of economic thinking at work in this literature, some more persuasive than others.

13 See eg Goddard 2000: 125–7, discussing the practicalities of not having an enforceable law of contract in Bangladesh. This is not to suggest that the rules of modern contract law should necessarily strive or be adapted to promote commercial needs: see **2.04**.

14 See Collins 1999: ch 5; and see further **2.04**. See also the discussion of 'self-help' remedies in **3.02–3.04**.

How and when did contract law develop?

1.09 The nature and origins of the common law

The modern law of contract in Australia, as in other countries colonised by the British (including the United States, India, Canada and New Zealand), is based on a set of principles that have their origins in the English common law. The term *common law* can have many different meanings: see *PGA v R* (2012) at [20]–[25]. But it is used here in the sense of a flexible body of rules formulated and developed by judges. Dating back to the twelfth century, and originally based on local customs, the English common law crystallised over a period of centuries into a set of recognised principles that could be applied to resolve legal disputes.[15] Although parliament came to be recognised as having the superior power to make laws, the common law could still fill the many gaps left by statutes and regulations.

Under the doctrine of precedent or *stare decisis* ('let the decision stand'), a court was expected to respect and 'apply' any previous decision by an earlier court that dealt with the same circumstances. This practice was facilitated by the publication of 'law reports' that summarised the facts of selected cases and reproduced all or part of the judgments given to decide them. In theory, once a common law rule was formulated by one judge, it was fixed for all time. In practice, however, a later judge might choose to 'distinguish' an earlier ruling, on the basis that it dealt with circumstances that were materially different. Some judges might overlook (deliberately or otherwise) a particular precedent, leading to conflicting 'authorities'. As the English courts became organised into hierarchies, it became more common for the 'superior' courts to have to resolve such conflicts. In this way the common law gradually evolved, with existing principles being qualified, refined and (occasionally) discarded as new decisions were given. It is now universally recognised that judges are at liberty to make new law as part of this process, within the constraints imposed by the doctrine of precedent: see eg *O'Toole v Charles David* (1990) at 267; *Commonwealth Bank v Barker* (2014) at [19]. But debate remains fierce as to how willing they should be to correct 'defects' in the law, and what factors should properly influence their decision-making.[16]

Unlike the civil codes that came to predominate in continental Europe, and that owed their origin to Roman law, the common law is by definition not set out in any authoritative document. Instead, it has to be gleaned or distilled from countless judicial rulings. In practice, many key principles are relatively uncontentious. But nevertheless, any attempts to 'state' the common law – including in a book like this one – necessarily involve informed guesswork. They are no more than predictions about how the authors expect a court to determine a case, based on what has gone before.[17]

15 For the best short overview of the history of the English common law, see Baker 2002: ch 2.

16 As to the debates over the respective merits of 'formalism' on the one hand, and 'pragmatism' or 'contextualism' on the other, see eg Thomas 2005: chs 3, 12; and see further **2.14**.

17 The extent to which courts are willing to have regard to the opinions of scholars (whether academic or otherwise), as expressed in textbooks or journal articles, differs from country to country, and from period to period: see the various articles in vol 29 no 1 of the *University of Queensland Law Journal* (2010). As to the particular status enjoyed in the US by the American Law Institute's *Restatements*, see **2.12**.

1.10 Development of the English law of contract

In Anglo-Saxon times, which ran from the fifth century to the arrival of the Normans in 1066, contracts required either swearing an oath or making an agreement and depositing a pledge in order to secure performance. A new law of contract began to emerge in the twelfth century.[18] Any structure was derived from the 'forms of action' then used in the courts: covenant, debt and trespass. Each action had its own distinct rules. In the thirteenth century, the action of covenant had the potential to develop into a catch-all action. The core of the claim was that an agreement had been entered into and was either not performed or mis-performed, with damages (an award of compensation) the standard remedy. But once use of a deed to record the agreement became mandatory in the early fourteenth century, covenant withered.[19]

Where a deed was used, the action of debt on a bond was an attractive option, especially for straightforward loan transactions. The name of the action was taken from the *bond*, which was a sealed instrument under which one person acknowledged that they were in debt to another. With the invention of the conditional bond, the action for debt became more flexible. Suppose A wanted B to build a house. B agreed to pay A £20, subject to a condition that the bond would be void if the house were built as agreed. This helped to secure performance and fixed a sum payable in the event of breach. The onus lay on B to show that they had performed. Failure to do so made them liable for £20, with very few defences available. In these circumstances, it is unsurprising that debt on a bond was the dominant contract action for many centuries.

Informal contracts were less easy to enforce. The action of debt on a contract was limited by the fact that although no deed was required, it could only be used in a claim for a fixed sum of money or goods. In the early Middle Ages, the actions of trespass, and trespass on the case, could be used in cases of contractual mis-performance and non-performance, because breaching an agreement was seen as a wrong (or what is now called a 'tort'). But during the thirteenth century, non-performance was excluded on the basis that 'not doing is no trespass'. This left gaps in the law relating to informal contracts in the important Royal Courts. Many such claims had to be litigated in the Local, Mercantile or even the Ecclesiastical Courts instead.

By the end of the fifteenth century, trespass on the case could once again be used for nonfeasance. From it, the action of *assumpsit* emerged. It took its name from the wording of the 'count' (ie the allegation in the claim): the defendant 'assumed and faithfully promised' to do something for the plaintiff. The count stressed that the obligation rested on a promise or contract. From around 1570, in order to bring assumpsit the plaintiff was also required to show that the promise was supported by good consideration. Consideration, as noted earlier, was based on the idea that the plaintiff had given something in exchange for the promise. Assumpsit was good at plugging gaps in the older remedies. It could be used for agreements for the sale of land and for services, and against executors where debt on a contract was unavailable. Plaintiffs also began to use assumpsit even where an action of debt could be brought, though some judges were still disinclined to allow this because there was an existing remedy. Matters came to a head in *Slade's Case* (1602), where a decision of all the judges

18 For a detailed account, see Ibbetson 1999.
19 For an account of this important development, see Baker 2012.