CHAPTER 1

INTRODUCTION AND OVERVIEW

¶1-000 THE PURPOSE OF THIS BOOK

This book examines the law that applies to commercial contracts in Australia. It is designed for use by students studying contract law as part of a business qualification at either undergraduate or postgraduate level. The book discusses how law affects the commercial operation of contracts by examining how business people use contracts and how contracts affect business dealings.

This book is not concerned with an examination of the rules of contract law for their own sake. While a discussion of rules is unavoidable, we aim to place the discussion in its commercial context. It is our hope that a practical discussion of how contracts are used in the real world, by using real life examples, will assist students to appreciate why a solid understanding of contract law is not only important for their university studies but also important for the success of their business careers.

¶1-010 FEATURES OF THIS BOOK

This book uses a range of pedagogical features that are designed to assist students as they move across the law of contract and develop an understanding of its practical application to common business transactions. Each chapter starts with an outline of the topic and a brief overview of the links between the different topics throughout the book. A number of practical examples are given to highlight the application of the law to business transactions. The principles of contract law are consolidated at regular points throughout the chapter with key summaries and flowcharts.

The law of contract is primarily based on cases, with many thousands of cases that have been developed over time in both England and Australia to give content to the law as it is applied in the real world. Our approach has been to focus mostly on leading cases, although some other useful cases are discussed as examples of the application of particular principles. We have highlighted key cases and case examples through the use of case summaries throughout each chapter to give students a more detailed understanding of the how the legal principles operate.

The students' understanding of the principles of law and their practical application is consolidated by sample questions at the end of each chapter.

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¶1-020 OVERVIEW OF THE AUSTRALIAN LEGAL SYSTEM

This section provides a brief overview of the Australian legal system for readers who have not previously studied law. This is an important preliminary step in understanding how contract law works in the real world. Readers with a satisfactory understanding of the legal system should move to [¶1-150].

¶1-030 What is law?

Law or "the law" generally refers to a system of rules that sets boundaries of acceptable and unacceptable conduct. The law may require a person to do something (eg to pay tax), or prohibit a person from doing something (eg stealing someone else's car). The law establishes a system of rights, obligations, duties and prohibitions that members of society, including people as well as business entities such as companies, must follow and obey. The law also provides consequences, remedies and penalties that may be applied if there is a breach of the law.

What distinguishes the law from rules that may apply in social and religious settings, or in the operation of the rules of a sporting or social club, is that compliance with the law is enforceable by the use of legal processes. Failure to comply with the rules of a club may lead to exclusion from the club, but failure to comply with a law may result in civil or criminal court proceedings. A breach of law may result in the levy of a fine, an order to pay compensation or to transfer property, or for severe breaches of criminal laws the imposition of a term of imprisonment (ie the deprivation of personal liberty). Compliance with the legal system is enforceable by the operation of state instrumentalities, ranging from the police to the courts to the system of property title and, for some, the bankruptcy system or the prisons.

It is important to distinguish between the different meanings of the term law. When a person refers to "the law" they may be referring to the legal system, or to a particular law. For example, to say: "It is against the law to steal" means there is a specific law that prohibits this conduct. On the other hand, to say: "Why does the law allow people to get away with this?" is referring to the absence of a particular rule prohibiting certain conduct. People may also refer to "the law" as the entire system of laws.

We can therefore make a distinction between "the law", which refers to the "legal system", and individual laws, such as the criminal law, corporate law, tax law and contract law.

¶1-040 Classifications of law

There are various ways to classify individual laws. We may group together laws based on whether they are:

- aimed at the relationship between persons and the government or between governments (public law), or whether the law is focused on the relationship between persons (private law).

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Public law includes topics such as constitutional law, criminal law, tax law, public international law and administrative law, while private law covers a broad range of topics including corporate law, tort law, trusts law, commercial law and contract law.

Another way of classifying laws is to focus on whether the laws are:

- aimed at establishing rights and remedies, duties and obligations (substantive law), or
- whether the laws are focused on how legal processes operate (procedural law).

Most areas of law may be classified as substantive, such as contract law. Examples of procedural law include the law of civil procedure (ie court rules and regulations), and the law of evidence.

Laws can also be classified according to whether they are:

- domestic (such as contract law) or international in focus (such as public international law and private international law).

Lastly, laws may be classified according to their origin. In this classification we draw a distinction between:

- laws derived from the common law, and
- laws derived from statutory law.

This last classification is probably the most important way to classify law. Different rules and procedures for interpreting and applying laws may be used for common law topics compared with statutory law topics. This is dealt with in the next section.

Sources of law

¶1-050 Overview

The common law forms the basis of Australia's legal system, as well as the legal system of the United Kingdom and most of the former British colonies, including New Zealand, the United States, Canada and India. The term "common law legal system" means that the legal system operating in that country is based on a combination of statutory law (made by a parliament of some kind), and laws developed and applied by the courts. In a common law legal system, the courts make law by interpreting the statutory laws and by progressing existing judicially developed legal principles.

It should be noted that the term common law can also be used to refer to areas of law that are not based on statutory law. Contract law is a common law area, as there is no contracts act or code that sets out all of the rules of contract law, those rules were and still are developed by court decisions.

Common law legal systems may be distinguished from other legal systems such as civil law systems (which are based on detailed civil codes), and sharia legal systems which are based on religious law. Each of these systems still have courts of various levels, but these courts are mostly just applying the provisions of the relevant code to the facts in dispute, rather than making law themselves. That is what distinguishes common law systems from other legal systems.

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The common law (as a body of legal rules), was developed in England dating back to the Norman Conquest in 1066. It refers to the legal principles that were determined by judges. Initially, citizens involved in disputes would come before local magistrates to resolve the dispute. This system existed in England long before the Norman Conquest and was continued by the Norman Kings. Later, the King had judges travel around the country to resolve disputes and eventually permanent courts were established in London.

The common law developed as judges recorded their decisions and court records became better organised and preserved. The reasons for judicial decisions could be applied in similar cases that came later. These written decisions and the reasons contained in them still form the basis of the common law in areas such as contract law and the law of torts (which contains negligence).

¶1-060 Common law and equity

The common law (ie the range of legal topics whose principles were developed by judges), may be contrasted with the law of equity. Over time, the common law became complex and formal, causing many to suffer unjust outcomes or to be completely shut out of the courts because they did not comply with what were often overly formal rules of procedure, or because they could not afford to comply with procedural requirements. Complainants could seek out the King's assistance, which eventually became delegated to the King's chief advisor, the Chancellor and his Court of Chancery.

The Court of Chancery did not need to apply the principles and formality of the common law courts, but rather focused on promoting fairness between the parties. Certain areas of law, such as the law of trusts and fiduciary duties, are creations of the law of equity. It is common to distinguish between principles of the common law and principles of equity. Equity is not however a self-supporting system, it works together with the common law. The law of equity provides a set of principles and remedies that may be used to relieve the harshness of the common law.

The law of contract provides a good example of the relationship between common law and equity. As we shall discuss in Chapter 3 (at [¶3-050]–[¶3-190]), the law of contract requires that legal consideration be provided in order to recognise and enforce a legal contract. There may be circumstances where the parties both expect that a formal contract has or will be entered into, but one of the parties decides not to proceed. That party may rely upon the lack of consideration provided at that point to argue that there was no legally enforceable contract. As consideration is an essential element of contract law that would mean that no contract existed at common law. The law of equity, however, may intervene by imposing what is known as an equitable estoppel to prevent one of the parties from denying the contract by relying upon their legal (common law) rights. Thus, the law of equity can recognise rights under the contract even where the common law would deny that a contract existed.

Another example in contract law also demonstrates the flexibility of equity compared with the common law. Suppose a man wishes to sell his Monet painting for $10m to a buyer and signs a contract with the buyer to sell the painting next week. In the meantime, the seller receives a better offer from another buyer to purchase the

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painting for $15m. The seller may break his contract with the first buyer and sell to the second buyer. This would cause the seller to be liable for compensation for breach of contract to the first buyer. However, this remedy is not really adequate compensation because the first buyer cannot simply go out and buy the same painting from another seller. Thus, the law of equity may intervene and impose a remedy requiring the seller to honour the first contract by transferring the painting, and not merely paying compensation for the breach of contract. In summary, the law of equity provides principles and remedies that are more flexible and fair than the common law.

The English Judicature Acts of the 1870s combined the separate courts of common law and equity, so that all courts now have both common law and equitable powers. This has been applied in all states and territories in Australia. An exception to this exists in NSW where, despite the judicature legislation and the conferral of both equitable and common law jurisdiction on all courts, the Supreme Court of New South Wales maintains both a Common Law division and an Equity division, each of which has a Chief Judge who manages the business of that division. The Supreme Court is overseen by the Chief Justice, and the Court of Appeal is overseen by the President. The Federal Court and the High Court are also overseen by a Chief Justice. This results in the Chief Justice being referred to as Bathurst CJ (for NSW), French CJ (for the High Court), and Beazely P (for the NSW Court of Appeal).

¶1-070 Common law, equity and statutory law

The common law and equity must be distinguished from statutory law. Statutory law is made by the parliament, and in federated jurisdictions such as Australia there are multiple levels of parliament that can make statutory law.

Statutory law is the highest and most authoritative form of law. Neither the common law nor equity may operate in a way which is inconsistent with clear statute law requirements. Thus, a court decision may recognize that a contractual party has certain rights in a particular situation, but the parliament may make a new statutory law that overturns the court decision and all subsequent cases are bound to apply that new statute law. Statute laws are usually presumed to be not retrospective in operation (ie they only have force from the date of their commencement), but it is possible to make a statute law that is deemed to have effect from a prior date. The obvious unfairness of such a rule means that this is rarely done however.

Parliament's power to make laws is derived from two sources. Firstly, state parliaments in Australia derive their statute law making powers from the settlement of Australia in 1788 which resulted in all English laws automatically applying in Australia. This was initially exercised by the colonial governors, but eventually colonial parliaments were established and were given the same unlimited statute law making power as the British Parliament.

The settlement of Australia was discussed in the famous High Court of Australia case *Mabo v Queensland (No 2)* (1992) 175 CLR 1. Prior to that case, the doctrine of *terra nullius* operated, which meant that Australia was held to be an empty place without laws so all of the English laws automatically applied. In *Mabo*, the High Court rejected this doctrine holding that Australia did have a form of legal system through Aboriginal customs. Importantly, the High Court held that this system was not

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automatically extinguished by settlement in 1788 and hence could have continued from that time and still operate. However, the court did note that customary law could be extinguished by making contradictory statute law as the parliament's law making power was superior to the existing customary laws.

The law making power of the British Parliament is ultimately derived from the Crown, which through a series of acts, concessions and documents (such as the Magna Carta entered into in 1215), gave parliament the right to pass laws. Certain powers are still retained by the Crown, which are known as reserve powers. In Australia, reserve powers are exercised by the Governor-General who is the Queen's representative in Australia. The most commonly used reserve power is the power to dissolve parliament and call an election, which is done only on the request of the Prime Minister (for the federal parliament) or Premier (for the state parliament).

In Australia, unlike in England which has a unitary system of government, the federal parliament is established by a written statute, the Commonwealth of Australia Constitution Act (the Constitution), which was passed by the British Imperial Parliament in 1900. The federal parliament (based in Canberra) derives all of its law making power from the Constitution. The formation of the federal system in Australia involved the colonial parliaments (which became state parliaments after federation), agreeing to give up some of their statute law making powers to the new federal parliament. This appears in various provisions in the Constitution, most importantly s 52 which gives exclusive powers to the federal parliament and Chapter VI which allows for the creation of new states and territories by the federal parliament. However, the main source of law making power given to the federal parliament is in s 51 which provides a list of several dozen areas on which it may make statutory laws, although these powers are shared with the state parliament. For example, s 51(ii) allows the federal parliament to make laws with respect to taxation, but states are also free to make taxation laws. Given this extensive overlap in statute law making powers, s 109 of the Constitution provides a dispute resolution clause which states that if state and federal laws conflict the federal law prevails to the extent of the inconsistency.

¶1-080 The separation of powers

The federal legal system established by the Constitution establishes a separation of law making power between the federal parliament and state parliaments. There is also a separation between the organs of government: the parliament; the executive and the courts. Australian law is based on the English Westminster model of government, which involves a strict separation between the courts on the one hand and the executive and the parliament on the other. A sitting federal judge cannot be a member of parliament or an executive of government (eg a departmental secretary). However, members of the majority party in parliament can be members of the executive government.

The executive is made up of a range of departments which employ public servants to implement government policy and to help develop new laws for consideration of the parliament. The executive is also responsible for enforcing the law through state police forces (for state laws), and the Australian Federal Police (for federal laws). The

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head of each department is a minister who sits in parliament and is thereby accountable to the people through regular elections. The head of the government, that is the leader of the majority party sitting in parliament, is the Prime Minister (for the federal government), or the Premier (for state governments). The Prime Minister and the ministers are technically appointed by the Governor-General with approval from the Queen. The state Premiers and state ministers are similarly appointed by the state Governors with approval by the Queen.

The parliaments of states, territories and the federal parliament consist of elected members (elections are usually held every three or four years). The federal parliament and most of the state parliaments have two houses, a lower house and an upper house. The upper house is the house where legislation proposed. In the lower house, it is reviewed and sometimes amended. Legislation must pass through both houses before it becomes a law. Territories and the State of Queensland have only one house of parliament where all parliamentary business is conducted.

The courts are set up by specific statutes which grant them powers to hear and resolve certain disputes. The court system is discussed at [¶1-100].

¶1-090 The role of the parliament

The primary role of parliament is to make new statutory laws and to amend where necessary existing statutory laws. This is done by considering a proposed new law, known as a Bill. The Bill may be introduced into either house of parliament, although some Bills must start in the lower house. The Bill is then debated and a vote is conducted in that house which must be passed by a simple majority. In some cases, the Bill may be sent to a committee for review and public consultation prior to a vote being held.

The process of introducing a Bill into parliament and then debating and voting on it can be rapid (for non-contentious or urgent bills) or can take many months. As the government always has a majority in the lower house, it is common for its Bills to pass relatively easily through the lower house. It is possible for members of parliament who are not also members of the government to introduce Bills (known as a private member's Bill), but this is rare as Bills without government support are unlikely to pass.

Once a Bill passes the lower house, it is sent to the upper house for review and a similar process occurs, through consideration and debate. The upper house also has a series of committees which may be used to review Bills. The process of Bills passing through the upper house may take longer than in the lower house because the government will not necessarily have a majority in the upper house. If the upper house wishes to amend the Bill (amendments are voted on by the upper house), it will be sent back to the lower house for consideration and voting. If a Bill is not passed by both houses of parliament, it does not become law. The Governor-General or Governor may dissolve parliament and call an election if laws cannot be passed through the parliament, although this is a dramatic step and is rarely taken.

Once a Bill has passed through both houses of parliament, it becomes law once the Governor-General or Governor signs it on behalf of the Queen. At this point, it is called an "Act" of parliament. For example, the Tax Amendment Bill 2014 (Cth)

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becomes the *Tax Amendment Act 2014* once it has passed parliament and been signed into law by the Governor-General. However, an Act of parliament will only become legally enforceable once it is "proclaimed". This may be done when the Governor-General or Governor signs the Bill, or it may be delayed to a later date to allow the community to adjust to the new law.

Statute laws passed by parliament can perform various functions. Firstly, a statute law may be a completely new Act. Secondly, statute laws may change or overturn an existing statute, which is referred to as amending or repealing an existing law. The same process for passage applies to both types of statutes.

There are, however, different levels of statutes. The most important level is the Act of parliament which is debated and passed by parliament. If a statute is going to create or vary legal rights, or will impose duties or penalties, then it must be covered in an Act of parliament. Underneath this level is a broad range of subordinate legislation, such as regulations, rules and orders. These are subordinate because they are made with a power contained in an Act of parliament. They are used to provide procedures that are used to comply with the Act of parliament. They are a useful tool for governments, and are usually drafted by government departmental officials, because they are not debated and passed by the parliament. Subordinated legislation (sometimes called delegated legislation) may be reviewed and overturned by the parliament if there are concerns about its operation.

¶1-100 The role of the courts

The courts play an essential role in the legal system. As noted above, the courts in a common law system are involved in developing law even in areas where there are no statutes. How courts do this is by determining how prior court decisions should apply in a new set of facts. The process of judicial decisions influencing future decisions is called *stare decisis* (which means let the decision stand). In common law systems, this is known as the doctrine of precedent, which means that future courts must follow decisions of higher courts in the same court system if their case has materially similar facts to the prior case. For example, a single Supreme Court justice in NSW is bound to apply the rule from a decision of the NSW Court of Appeal on materially similar facts. Decisions of courts from other jurisdictions are not binding precedents, but may be persuasive. Thus, the same decision of the NSW Court of Appeal would not bind a Victorian Supreme Court justice, although it could be followed or applied on a voluntary basis. Decisions of the High Court of Australia bind all courts and tribunals in Australia. It is common for courts to consider and rely upon decisions involving similar issues from other Australian courts, and in some cases, English cases or cases from other common law countries.

Courts also influence the shape of the law by the way in which they interpret statutory provisions. Courts must determine how statutory provisions apply in a range of factual circumstances, which can lead the court to consider issues such as the policy underpinning the provision and the stated purpose of the statute to determine whether the provision applies to a given situation. These decisions will then bind future courts that are lower in the same system.

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Courts operate in a hierarchy from lower level courts (eg the Magistrates or Local courts) to intermediate courts (eg the District Court or County Court) to the Supreme Court. Once in the Supreme Court, a case is usually commenced before a single judge, whose decision may be appealed to a three member Court of Appeal or Full Court. Decisions of the Court of Appeal or Full Court may be appealed to the High Court of Australia, although the High Court must first grant special leave to appeal. There is no further appeal from a decision of the High Court of Australia.

Courts in Australia are divided according to their jurisdiction (which refers to the power to make decisions on particular topics). Each state and territory in Australia has a Supreme Court, which is a direct descendant of the courts that operated in England at the time of settlement in 1788, albeit supplemented with statutory power by a constituent Act of parliament. The federal courts did not exist prior to federation and hence are established by the Constitution. The Constitution makes provision for the High Court of Australia and for "such other federal courts as parliament creates". Since 1975 there has also been a Federal Court of Australia, with appeals from the Full Court to the High Court. The Federal Court decides disputes on federal law (such as tax, intellectual property and immigration).

Each Supreme Court as well as the Federal Court and the High Court of Australia have two separate powers to resolve disputes (known as jurisdiction). The first type of jurisdiction is original jurisdiction, which refers to a trial of a dispute, usually before a single justice. If an appeal is made, the court hearing the appeal is exercising appellate jurisdiction, usually through three, five or seven justices. The High Court's role, and the role of Courts of Appeal and Full Courts is almost entirely appellate cases.

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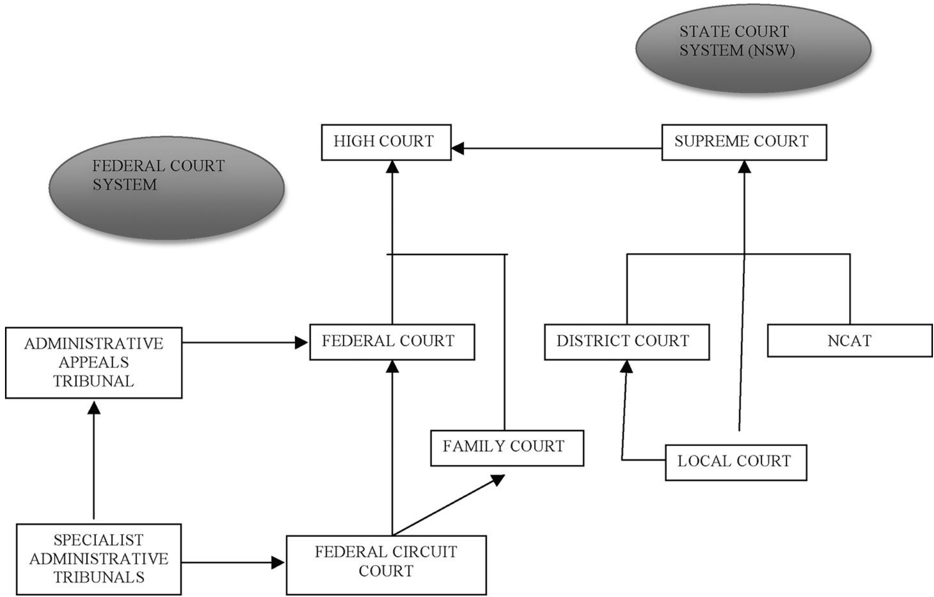

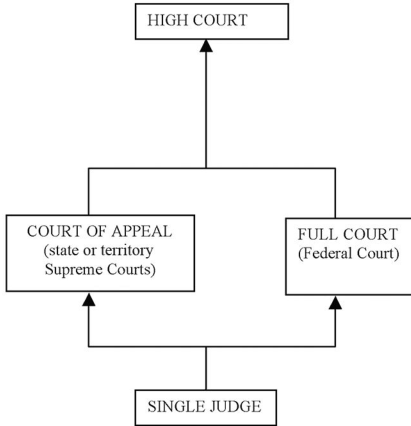

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¶1-110 Tribunals

One important element of the judicial system is the increasing role of administrative tribunals. These are bodies that assist with resolving disputes, usually involving the government and individuals or businesses. Some tribunals exist for resolving private disputes between persons.

Tribunals may be limited in scope, such as the Migration Review Tribunal, or general in nature such as the Administrative Appeals Tribunal (AAT), which is a commonwealth tribunal that hears disputes involving challenges to federal government decisions. Several states now have general tribunals that cover both administrative law challenges to government decisions as well as resolving certain private disputes (eg small civil claims or residential tenancy disputes), such as the VCAT (Victorian Civil and Administrative Tribunal) and the NCAT (NSW Civil and Administrative Tribunal).

Tribunals have become popular because they offer a less formal and less expensive means of resolving disputes than courts. They are not a substitute for courts because they are not usually determining legal rights, but rather resolving disputes about the application of particular laws. There are avenues of appeal on points of law from tribunals to the Supreme Court or Federal Court (depending on the jurisdiction), and thereafter to the High Court.

¶1-120 Alternative dispute resolution

Much of the law is based on adversarial contests that are fought out in court cases with the judge determining the result by making an order for a legal sanction. This is quite a limited way to resolve disputes. Courts are good at determining legal rights by applying legal rules so as to award a legal remedy that can be enforced by legal process. In some cases, this is the only way to resolve a dispute between two or more parties. It is, however, a costly and time consuming process. The cost of access to the courts, particularly for prolonged litigation, is simply beyond most people in society and may be too much even for many businesses. It is not uncommon for court cases to cost $100,000 or more. Furthermore, in Australia if a party loses their court case they must usually pay the winner's costs.

In response to these issues, a variety of alternative dispute resolution (ADR) mechanisms have become popular. These include negotiation, mediation, facilitation, expert determination and private arbitration. It is common for ADR processes to be built into commercial contracts to minimise the risk of litigation. This prevents the parties going to court to resolve their disputes before they have at least tried the ADR process set out in the contract. ADR processes are now also compulsory in most court proceedings to try to get parties to resolve or at least narrow the dispute before taking up court time and increasing the costs of litigation.

Alternative dispute resolution processes offer the advantage of being less formal and more flexible than court processes. ADR resolutions are not limited by legal forms of redress such as awards of compensation and so may be tailored to meet the needs of all parties (if possible). Some common types of ADR are described in Chapter 9 at [¶9-940].

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How to read and understand the law

¶1-130 Legislation

Legislation is identified by the name of the statute (whether it is an Act of parliament or subordinate legislation) and what year it was passed by the parliament. For example, the *Corporations Regulations 2001* (Cth) was passed in 2001 by the federal parliament. It is common for an abbreviation of the legal jurisdiction to be given after the year the statute was passed:

- (ACT) or (NT) for legislation made in the territories
- (NSW), (Qld), (SA), (Tas), (Vic) or (WA) for legislation passed in the states, and
- (Cth) for legislation passed by the federal parliament.

Most statute laws will contain their own dictionary or definitions section, usually at the start or at the end of the statute. It is also common for specific terms used within a particular section or part of the statute to be defined in a specific provision in that part of the Act or Regulation. Each legal jurisdiction also has a general interpretation statute that provides definitions and rules of interpretation for statutes passed in that jurisdiction. For federal laws, the statute is the *Acts Interpretation Act 1901* (Cth). Thus, it is important for words and phrases in statutes to be interpreted using the provisions of that statute (and its dictionary or definitions provision), as well as the rules and definitions in the Acts Interpretation Act (or state/territory equivalent). The courts have also developed a series of rules of common law to assist in interpreting legislation.

Acts and Regulations are usually broken up with Parts, Divisions and Sub-divisions, each with its own heading. The actual provisions of the statute will be designated as a section (for an Act), or a regulation, rule or order (for subordinate legislation). As each part of a statutory provision may contain a separate rule it is important to be specific when citing a rule.

Sections of an Act of parliament may be broken up into paragraphs, parts and sub-parts. For example, s 180(1)(a) refers to paragraph (a) of sub-section (1) of section 180 of the Act. Some Acts of parliament may descend into further levels of provisions such as (i), (ii). Subordinate legislation is structured in a similar way, although regulations are cited as "Reg", eg *Corporations Regulations 2001* (Cth) Reg 2.5. Multiple sections of an Act may be cited by "ss" and multiple regulations may similarly be cited as "rr". Both Acts and Regulations may contain Schedules at the end of the statute. Provisions in Schedules are usually referred to as "clauses", for example *Corporations Regulations 2001* (Cth) Sch 8A cl 1.

¶1-140 Cases

Cases are cited according to who the parties to the dispute were. Thus, *Smith v Jones* refers to a court decision involving both Smith and Jones. The order of the parties is usually determined by who is bringing the action (the plaintiff or applicant), followed by the party who is defending the action (the defendant). In this example, Smith brought a court application against Jones. If an appeal is lodged against the outcome,

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then the party bringing the appeal is the appellant and the party defending the appeal is the respondent. Thus, if Smith won her case against Jones and Jones wished to appeal, the appeal case would be *Jones v Smith*. If Smith lost her first case and wanted to appeal, then the appeal would also be *Smith v Jones*.

It is possible for a court case to only have one party in which case the decision will be *Re Smith* (ie in the matter involving Smith). In some cases the application may by brought by one party against another party but the defendant is not participating in the case. In that case, the citation would be *Re Smith; Ex parte Jones*, which means that Smith has brought the case and Jones is involved but is not actually participating in the litigation.

One common point of confusion involves the government as a party to litigation. In civil cases, the government will usually be cited simply by its abbreviation, such as *Smith v NSW* (Smith is suing the government of NSW). Sometimes the action will be against a particular minister, such as *Smith v Minister for Health (NSW)*. In criminal cases, the government is always a party but is usually cited either as Crown (eg *Crown v Smith*), or as R (which stands for Regina or Rex, depending on the gender of the monarch) such as *R v Smith* or as the Director of Public Prosecutions (eg *DPP v Smith*). Particular government agencies such as the Australian Securities and Investments Commission may have their name in full or may be abbreviated (to ASIC, eg *ASIC v Smith*).

Case citations also contain a reference to the year of the decision. For example, *Smith v R* [2014] NSWSC 50 is a reference to a decision of the NSW Supreme Court (NSWSC) which has been given the number 50 for the year 2014. Each decision is given this unique number so that it can be identified and distinguished from other cases involving the parties. Many (but not all) decisions are also published in specific law reports that are produced by commercial publishers. Each court has its own law report series:

- Commonwealth Law Reports (CLR) — for the High Court of Australia.
- Federal Court Reports (FCR) — for the Federal Court of Australia.

In addition, each state and territory has its own report series for the decisions of its supreme court and its appeal court or full court:

- ACT Reports (ACTR)
- NSW Law Reports (NSWLR)
- Northern Territory Reports (NTR)
- Queensland Reports (Qd R)
- South Australian State Reports (SASR)
- Tasmanian Reports (Tas R)
- Victorian Reports (VR), and
- Western Australian Reports (WAR).

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In addition to these reports, there are a range of specialist reports for a number of areas such as tax, family law, corporate law and employment law. Important cases may have a number of citations as they will be published in official court reports as well as specialist reports, but the paragraph numbers should remain the same across each report series.

The brackets that surround the year after the party names are important. Round brackets (1989) state the year that the case was decided, while square brackets [1989] provide the year volume that the case was published in. Thus, *Smith v Jones* [1989] HCA 5; (1989) 175 CLR 1 refers to the fifth case decided by the High Court in 1989 which was published on p 1 of Vol 175 of the Commonwealth Law Reports.

The square bracket citation is used mostly for English cases, which are important for Australian law as many of the leading cases on aspects of Australian law are English cases that have been applied on numerous occasions by Australian courts. This is particularly so for contract law where most of the foundational cases are English cases from the 19th and 20th centuries.

WHAT IS A CONTRACT?

¶1-150 Overview

One of the leading commentators on contract law in Australia has defined a contract as "a legally binding promise or agreement".[1] This somewhat simple statement contains several elements:

a) a promise or agreement
b) that is binding in law.

A promise is an undertaking by one person to do something, or to refrain from doing something. For example, the statement:

> "If you paint my house I will pay you $5000."

contains a promise by me to pay a certain amount of money ($5,000) if the condition of you painting my house is satisfied. If you agree to this arrangement we can be said to have an <u>agreement</u> involving you performing a task in <u>exchange</u> for me paying you money.

¶1-160 The requirements for a legally binding contract

A mere promise is not necessarily a contract. In order for the promise to be classified by law as a contract it must be *legally binding*. The requirements for a legally binding contract are determined by the common law of contract and may be summarised as follows:

- there must be an agreement between the parties
- that agreement must be supported by legal consideration
- the parties involved must have the legal capacity to enter into contracts

1 Carter, *Carter on Contract*, LexisNexis, [¶1-001].

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- the parties must genuinely consent to entering into the contract
- the parties must have intended to become bound by their promise or agreement
- the subject matter of the contract must be sufficiently clear and comprise terms that allow the agreement to operate, and
- the subject matter of the contract must not be prohibited by law.

Each of these elements may be broken down into a series of rules, sub-rules and exceptions all of which have been discussed in a number of court cases that together form the "law of contract". This is an area of law that is largely determined by court decisions rather than by the parliament. A contract that is legally binding is capable of being enforced by the law of contract, as applied by Australian courts.

The fact that contract law is determined by the courts and not by state, territory and federal parliaments does not mean that laws made by the parliament are irrelevant to contract law. Laws made in parliament are called statute law and cover a wide range of areas that may also be relevant to particular contracts. For example, consumer credit contracts are regulated by the National Credit Code, which is a federal statute.

The characteristics that make a promise or agreement legally enforceable can be used to distinguish contractual promises (ie legally enforceable promises), from promises, agreements or other undertakings that are not contracts. A promise by a father to pay his son $10 for washing the dishes is a promise. If the son agrees to undertake the task in exchange for the promise of payment then there is an agreement. However, this would not be a contract because the parties (ie the father and son) do not intend their agreement to create legally binding relations. To put this in the language of contract law, the parties to the agreement (to wash the dishes in exchange for $10) do not intend to form a legally binding contract. The rules relating to an intention to create binding legal relationships will be discussed further in Chapter 3 at [¶3-330].

This is a very legal perspective of contracts, however. In the business world, a contract is an agreement providing some practical benefit for one (and hopefully all) parties to the contract. Business people understand what the contract is through the commercial benefits they hope to extract from the relationship that frames the contract. A contract is not merely a set of legally enforceable terms and conditions, it is an undertaking by two or more persons (usually involved in the transaction as representatives of a commercial enterprise) to perform obligations as part of their business. A successful contract will fulfil the parties' expectations of what they were hoping to get out of the contract. This may pose a challenge where the relationship changes over time. Contracts can be flexible and can be changed by the parties, which is discussed in Chapter 6.

The parties to a contract

¶1-170 Overview

Each contract must have at least one legal person (either an individual with the capacity to enter into a contract or a body such as a company), who agrees to be bound by the contract (known as a party to the contract). A contract that only has one party is called a "deed poll". This is a formal type of contract that requires a deed to make it

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legally enforceable. Most contracts will involve two or more parties. A contract involving an exchange of promises is called a bilateral contract. A contract with multiple parties may also use a deed, and in some situations a deed is required. A contract using a deed is called a formal contract because deeds have certain formal requirements under law, such as the need to be signed. All other contracts are called simple contracts. Formality requirements for contracts are discussed in Chapter 3 at [¶3-580]–[¶3-690].

It is common for a contract to have two parties, with each party promising to do something of value or to refrain from doing something that generates value. For example, a customer promises to pay a builder $200,000 if the builder promises in return to build the customer's house. Both parties to the contract are making promises. The parties making promises are referred to in contract law as the promisee and the promisor. The promisor makes a promise to which the promisee responds. As we will see in Chapter 3, it is important that the promisee undertake action in response to the conduct of the promisor. It is this exchange of promises that produces the consensus upon which the law of contract is based. If the parties do not agree on anything, there is no contract.

¶1-180 Parties involved in business contracts

The terms promisor and promisee are general terms that may refer to a range of legal persons. Either or both parties to the contract may take the form of individuals representing themselves or may be any one of a variety of legal structures, such as companies, trusts or partnerships. The parties who actually negotiate the contract may be doing so for their own benefit, or may be acting as an agent for someone else as principal. Any person who has the legal capacity to enter into a contract may authorise another person to enter into that contract on their behalf. The principal (ie the person who authorises the agent) will be the party to the contract and not the agent who signs "for and on behalf of" the principal.

Under the law of agency, the principal is liable for the conduct of the agent that is within the express authority of the agent. The principal may also be liable for the conduct of the agent that appears to fall within the scope of their authority (known as ostensible or apparent authority). Where one or more of the contractual parties is a company or a large partnership, it will be common for the contract to be negotiated by one or more persons, who will refer the contract on for signature by persons with higher authority within the organisation, usually the partners in a partnership or the board of directors in a company. Thus, a mid-level manager may negotiate the terms of the contract and then submit it for signing by the CEO or by the board of directors. A similar process could be used in a partnership, with the partners signing off on a contract negotiated by an employee.

It is important therefore for parties negotiating contracts to determine:

a) who will be the other party to the contract (ie the person negotiating or another person for whom they are negotiating as agent), and

b) whether they have the authority and capacity to enter into a contract of that kind.

Issues of formal legal capacity will be discussed in Chapter 3 at [¶3-260]–[¶3-320].

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A special note should be made about contracting with trustees. A trustee's legal authority to deal with trust property is limited by the terms of the trust deed which established the trust. If a trustee enters into contracts that are outside the terms of the trust (or prohibited by the trust deed), then the trustee will be acting in breach of trust and may be liable for various consequences, including compensating the trust for lost property. Importantly, a third party who assists a trustee in breaching the trust may also be liable.

Certain trust deeds may also limit the ability of the trustee to claim against the trust property for costs incurred in administering the trust (including entering into contracts as trustee), which may make enforcing the contract or obtaining compensation for breach of contract difficult for the other party to the contract. It is therefore imperative for those dealing with a trustee to have their lawyer examine a copy of the trust deed to determine what the risks of entering into a contract are.

¶1-190 The elements of a business contract

A contract can involve a single transaction (eg the sale of goods), or a continuing relationship (eg a franchise agreement or long-term lease of goods). A contract may be put in writing and signed by all parties, or may be merely a verbal agreement, or a combination of one or more written documents as well as a verbal agreement.

It is common for business contracts to have at least some of their terms in writing. Contracts may be a simple single set of terms, may be made up of multiple documents, or may involve a series of connected contracts. For example, it is common for contracts for the sale of goods to involve a master supply agreement (MSA) between the supplier and its customer. This agreement contains standard terms of the contract governing the overall relationship between the parties. Such an agreement may be supplemented by further terms and conditions notified separately (eg by posting on the supplier's website with a reference to this in the written document that passes between the parties). Therefore, the contract between the supplier and its customer will include the MSA terms on the supplier's website as updated from time to time and any provisions included through notice to the customer in order forms, invoices and other documents passing between the parties. We can add verbal conversations between sales staff and the customer to this mix of documents. Master agreements are a very common part of business transactions and are often standardised across whole industries, eg certain forms of building and construction contracts and some finance contracts (eg derivatives contracts).

When the law speaks of the contract, it is referring to the legally binding agreement between the parties which may take its provisions from a mix of written and verbal promises which pass between the parties. Determining what is the actual agreement between the parties may involve considerable time and effort. In practice, all business people are limited by their own understanding of what the contract involves based on their perception of what has been agreed. This may not be the same understanding of the contract as the other party or parties have of the agreement. The limitations and potential irrationality of human perceptions are an important reason why business people need clearly written contracts that make sense to all parties. The responsibility

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for understanding what the contract actually involves does not fall only on the lawyer who drafts the document, but primarily on the business person who will be the one using and relying on the contract.

¶1-200 THE LIFE CYCLE OF A CONTRACT

A contract may be examined according to a particular life cycle. The life cycle of a contract involves:

a) negotiation
b) formation (including drafting the contract)
c) execution (signing the contract)
d) implementation (using the contract to obtain benefits)
e) interpretation (particularly if there is a dispute)
f) enforcement, and
g) termination.

The identification and enforcement of the terms of the contract are likely to become important if there is a dispute between the parties as to what the contract allows or requires. If a dispute arises, the relationship between these stages becomes apparent.

For example, suppose a customer is unhappy because they were supplied with what they believe are sub-standard goods. The supplier states that the specific quality demanded by the customer is not in fact part of the contract (or for the purposes of arguing about remedies is not at least an essential term of the contract). The customer may refuse to accept delivery of the goods or refuse to pay for the goods they have already received. The seller may take court action to recover payment for the goods by arguing that the terms of the contract require payment. The customer on the other hand will argue that there has been a breach of the contract by the supplier. The customer might also argue that they were misled into executing the contract because of representations about quality made during the negotiation phase. Thus, one simple dispute can generate issues from each stage of the contracting life cycle. This book will consider the range of legal rules that are relevant for business people at each of these stages in the life cycle of the contract.

¶1-210 WHAT IS CONTRACT LAW?

Contract law, or the law of contracts, refers to the collection of legal rules that determine the formation, application, variation and termination of contracts. The law of contract applies equally to business contracts as well as other legally enforceable agreements that are not in commercial settings. We can categorise contract law as being:

- part of the civil law rather than criminal law, and
- an area of private law rather than a topic of public law.

This means that contract law is largely concerned with agreements between private parties, although government entities can also enter into legally binding contracts with private citizens and businesses.

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Contract law is primarily made up of court decisions in Australia and England over the past several hundred years. The collection of these decisions forms part of the common law legal system. Unlike many areas of law (such as tax, corporate and competition law), contract law is not derived from legislation. There is no uniform Contracts Act that sets out the law of contract.

That is not to say that contract law is not affected by legislation. There are many statutes that affect the way that contracts may be formed, the subject matter of contracts and how contracts operate. One of the most important statutes that affects the operation of business contracts is the Australian Consumer Law (the ACL), which is found in Sch 2 of the *Competition and Consumer Act 2010* (Cth). Although this is a federal statute, it has been applied to each state and territory in Australia so it is national uniform legislation that is enforced by both the Australian Competition and Consumer Commission (the ACCC) and state and territory fair trading departments.

The ACL can affect contracts in many ways, particularly when businesses deal with consumers. It prohibits some types of contractual terms, prohibits misleading conduct (including during contractual negotiations), and maintains minimum standards and remedies for defective products and services. The ACL will be discussed at various points throughout this book.

¶1-220 THE RELATIONSHIP BETWEEN CONTRACT LAW AND OTHER AREAS OF LAW

Contracts form the basis of most business transactions, including leasing contracts, employment relationships, business loans, orders of trading stock and equipment and dealings with customers. That does not mean, however, that contract law is only relevant to business people, or indeed that legal problems arising in business transactions are necessarily best solved by looking to the rules of contract law. Contract law operates as part, albeit an essential part, of the web of laws that affect individual business transactions and individual business relationships.

Other areas of law that may be relevant in assessing the legality of a business transaction may include:

- competition and consumer law
- the law of fiduciary obligations
- equitable obligations of confidence, and
- the law of torts.

The internal operations of a business are likely to be shaped by (at a minimum):

- employment and industrial law
- corporate law
- fiduciary obligations
- agency law

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- the law of trusts
- secured transactions law, and
- tax law.

The relationships a business has with its customers may generate legal issues arising in:

- sale of goods legislation
- competition and consumer law
- the law of torts (particularly negligence)
- consumer credit law
- secured transactions law, and
- privacy law.

It is important to understand the central role that contracts, and contract law, have in regulating business transactions, and also the extent to which other laws may apply to the situation. Put simply, contracts determine the nature and scope of the transaction itself. Contracts determine who the parties to the transaction are, what they are dealing with and what their rights, obligations and liabilities are. Other areas of law are imposed onto the existing contractual relationship.

Multiple areas of law can work together in the same situation, which may give rise to concurrent rights and liabilities. This may occur, eg where conduct that would be a breach of contract may also breach a statutory rule and/or may breach a tortious duty or give rise to an equitable remedy. The innocent party who suffers the breach may then elect how they will claim their remedy (ie by relying upon rights in either contract law, under statute or the law of equity). There are complex rules governing how remedies may be awarded in such situations. It is sufficient to note for present purposes that, while contract law establishes the basis of most business relationships, it is by no means the only area of law that affects business relationships. Some other areas of the law that often operate closely with contract law are discussed in Chapter 9.

¶1-230 THEORETICAL PERSPECTIVES

The law of contract has been the subject of detailed and prolonged theoretical analysis. These debates are concerned primarily with what a contract is, and how the law can justify upholding the legal enforcement of contracts. The traditional theory of contract law is based upon the will of the parties. That is, the contract is the expression of the free will of the parties and should therefore be respected by the law. This perspective is based on libertarian ideology which is focused on individual rights and freedom. This view also fits with laissez faire economic principles arguing for deregulation and allowing parties to determine their own rules. Classical contract theory sees private ordering through upholding "freedom of contract" as being of paramount importance, rather than government intervention in private business dealings.

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Classical contract theory is open to the criticism that for various reasons the final expressed contract may not represent the actual will of the parties. The courts do not necessarily reveal the true will of the parties in contractual disputes, but rather impose objective standards and principles on the contractual relationship. Many contracts, particularly business contracts, involve little or no negotiation but are rather presented as standard form contracts on a take it or leave it basis. This undermines the freedom of contract argument based on the expression of free will by each party. A further argument against classical contract theory, and its free will focus, is that many aspects of contract law are more public than private in nature. Indeed, state enforcement agencies are necessary for both the creation and enforcement of contracts. A contract only exists, and only has force, because the law and the legal process allow it to be. The ability to bargain over contractual terms is grounded by the legal personal and property rights each party has been given by the state. At [¶1-160], we discussed that a contract must be intended to be legally enforceable, which distinguishes it from other social or family agreements that are not contracts.

Another perspective on contract law is provided by law and economics scholars, such as US Judge Richard Posner. Economic perspectives on contract law are focused on voluntary transactions, as in classical contract theory, but see the role of contract law in reducing the cost of those exchanges as most significant. Economic perspectives on contract law are concerned with improving the efficiency of transactions by lowering transaction costs. For example, in the absence of contract law parties would need to bargain and negotiate terms that are provided by the law of contract. Hence, contract law allows parties to not waste time bargaining over terms already imposed as default rules.

Contract law also serves to fill gaps in what would otherwise be an incomplete bargain. It is difficult (if not impossible) for parties to anticipate and protect themselves from every eventuality, thus making contracts necessarily incomplete. Contract law thus serves a useful function in filling these gaps with default rules. Economic perspectives argue that the role of law in private contracting should be limited to the terms parties would consent to if they were asked *ex ante* (ie before the transaction actually takes place).

The economic analysis of contract law is open to the criticism that it is based on the classic economic ideal of rational, wealth-maximising autonomous individuals. Modern developments in behavioural science have been used by economists to demonstrate that people do not always act rationally in their own self-interest. This can be seen through the concept of bounded rationality, which demonstrates that real people (as opposed to the hypothetical rational economic wealth maximisers used by classical economic theory) make decisions under a number of cognitive biases that influence their decisions.

Another criticism of classical economic theories of contract is based on the fact that classical theories tend to analyse contracts as single isolated transactions. The behaviour of individuals may differ if they are involved in long-term relationships through a series of contracts compared with one-off transactions. The response to this has been the growing literature concerned with "relational contracting", which looks at long term contractual relationships. Relational contract theories are not specifically concerned with the optimal design of contract law, but do pose challenges to the force

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of classical contract law theories, suggesting that adjustments to formal contract law rules may be needed to accommodate different forms of contractual relationships. Contract law has responded to such criticisms through the development of doctrines such as implied terms of good faith, discussed in Chapter 5 at [¶5-240]–[¶5-270]. The broader body of law has also responded through the development of principles concerning estoppel and unconscionability, as well as statutory consumer protection laws.

A deeper criticism of classical contract theories can be found in texts on feminist legal theories. These offer a diverse range of scholarship that cannot be neatly summarised. However, one fundamental aspect of feminist legal theory is the recognition that traditional contract theory upholds existing property rights, typically valued in monetary terms and ignores other values/benefits which parties may derive from the contractual relationship. Feminist theories argue against the masculine viewpoint which stresses the role of law in facilitating dispute resolution between the holders of legal rights, particularly when the allocation of legal rights is narrowly focused on economic wealth and power. Feminist perspectives on contract law challenge society to recognise what contract law is doing, and also what it excludes. Such perspectives thus encourage a broadening of the legal system to value non-economic aspects of social and business relationships such as trust, support and equality.

¶1-240 CHAPTER SUMMARY

This chapter has:

- considered the nature and role of law in general, including the sources of law and different classifications of law
- explained the relationship between statute and case law and discussed how to refer to each source of law
- explained what contract law is and how it relates to other areas of law, and
- discussed the range of contracts, contractual documents and parties to the contract.

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