BUSINESS LAW GUIDEBOOK

SECOND EDITION

CHARLES YC CHEW

CHAPTER 4: CONTRACT: TERMS AND REMEDIES FOR BREACH

TEST YOUR KNOWLEDGE

1. The terms of a contract may be either express or implied. Explain what is meant by this statement in some detail.

ANSWER

Express terms are actual terms, which the parties have specifically made, and which they intended to be part of the contract. In written contracts, express terms will be terms that are written and agreed to between the parties negotiating the agreement: *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (1994) 218 CLR 471. In oral contracts, express terms will be those which are spoken and which are actually agreed between the parties.

No contract can (even if the parties attempt to) address all the contingencies that can arise. Even the most carefully written contract cannot provide for every eventuality. Sometimes, it is evident that certain terms were intended by both parties but, through inadvertence, oversight or inadequate drafting, were not incorporated in the contract. In such circumstances, terms have to be implied into the contract to 'fill the gaps' to overcome this omission which, if left uncorrected, would defeat the presumed intention of the parties. Terms may, in certain circumstances, be implied into a contract by the court, by custom or trade usage, or by statute.

2. When does the parol evidence rule apply? What are the exceptions to this rule?

ANSWER

Where the parties have expressed their agreement wholly in writing, the 'parol evidence rule' will apply. The rule states that if the written document is intended by the parties to contain a complete record of their transaction, extrinsic evidence is not admissible to add to, or vary, or contradict it: *Mercantile Bank of Sydney v Taylor* (1891) 12 LR (NSW) 252.

If the parol evidence rule is applied strictly, it could lead to injustice and hardship. Consequently, there have been developed the following exceptions to the rule:

- Extrinsic evidence is admissible to show that a custom or local usage is part of the contract, even though it was not specifically referred to. In the same way, evidence of usage to explain the meaning of terms of art or technical words in a document is admissible: *Hutton v Warren* (1836) 150 ER 517.
- Oral evidence of surrounding circumstances may be admissible to clarify any ambiguity in language where, for example, the words in the written contract are not adequately articulated or are susceptible to more than one meaning: *Rankin v Scott Fell & Co* (1904) 2 CLR 164.
- Collateral contract is where a party whose statement has been excluded from a written contract by the operation of the parol evidence rule can, in the alternative, plead collateral contract, which is a contract, the consideration of which is the entering of another contract: *De Lassalle v Guildford* [1901] 2 KB 215.
- Oral evidence is admissible to demonstrate that the contract is not valid because of misrepresentation: *Howard Marine & Dredging Co Ltd v A Ogden & Sons (Excavations)* Ltd [1978] QB 574; *Leason Pty Ltd v Princes Farm Pty Ltd* [1983] 2 NSWLR 381.

3. Explain the guidelines which you think the court may have to use in determining whether a statement was intended to form part of a contract.

ANSWER

In determining whether a statement was intended to form part of a contract, the court will have to assess its scope and meaning. The court will also be examining the evidence surrounding the transaction, including the conduct of the parties, before and after the agreement is made. It will have to look beyond the document and take account of its context.

4. The terms of a contract are categorised according to their significance. What are the important terms and what are the less important terms?

ANSWER

In relation to the importance of contractual terms, it has been traditional to distinguish between 'conditions' and 'warranties', and this distinction remains the most important.

A condition is a major term of the contract. It is a term that 'goes to the root of the matter, so that a failure to perform it would render the performance of the rest of the contract … a thing different in substance from what the defendant has stipulated for': *Bettini v Gye* (1876) 1QB 183 at 188. If a condition is breached, the innocent party can terminate the contract (at his or her election) and can also claim for damages.

A warranty is regarded as being of less significance or importance and therefore a minor term of the contract, the breach of which renders the contract different but not substantially different.

5. What is an intermediate or innominate term?

ANSWER

It is sometimes difficult for a court to determine whether a term of a contract is a condition or a warranty. In fact, by its nature, it is neither. Such a term is called an intermediate or innominate term: *Hong Kong Fir Shipping Co v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26; *L Shuler AG v Wickham Machine Tool Sales Ltd* [1974] AC 235.

6. Explain briefly under what circumstances are implied terms used.

ANSWER

Generally speaking, courts are unwilling to imply terms into a contract, because it is believed that their task is to interpret what the parties have actually agreed, and not to make the contract for them. Nevertheless, occasionally, it is obvious that certain terms were intended by the parties, but through inadvertence or bad drafting, were not incorporated into the contract. The courts will in these circumstances, imply terms into the contract if the addition is necessary to make the contract truly reflect the intentions of the parties. Terms may be implied in basically three ways:

- by the court
- by trade usage or custom

- by statute.

7. What is the court's attitude to uncertain terms?

ANSWER

The court's view is that uncertainty or vagueness should not invalidate an agreement where it cannot reasonably ascertain what the parties intended. What this means is that if the intentions are clear, or if they are capable of being ascertained with reasonable certainty, the court will give effect to them. This principle was encapsulated in *Scammell v Ouston* [1941] AC 251 where it was said that 'the court will do its best, if satisfied that there was an ascertainable and determinate intention to contract, to give effect to that intention…. It will not be deterred by mere difficulties of interpretation' at 268 per Lord Wright. See *Hillas & Co v Arcos Ltd* [1932] All ER Rep 494.

8. Exclusion terms are commonly used express terms. Yet the courts are generally hostile to exclusion clauses and have even developed rules to limit their effectiveness. Why is this so?

ANSWER

The courts are generally speaking hostile to exclusion clauses, especially where the parties to the contract are not of equal bargaining power. The reason is that the exclusion clause is usually contained in a standard form contract and is presented in a 'take it or leave' manner to the weaker party who is not able to negotiate for its deletion. Courts have developed rules to limit the effectiveness of such a clause by placing a heavy burden on the party seeking to rely on it to show that it is in fact part of the contract. If that cannot be established, the clause will not be effective or binding. Where the clause is held to be part of the contract, the courts will interpret it strictly so that the scope of the clause and thus its effectiveness can be limited.

9. Where a party signs a document containing an exclusion term, is he or she bound by such a term?

ANSWER

The party who signs the document is bound by the exclusion term only if:

- the other party who is seeking to rely on the term has brought the term to his or her notice before or at the time the contract was made
- the nature of the term is not misrepresented
- the term does not refer to events falling outside the scope of the contract in a way that is not contemplated or intended by the agreement.

10. What remedy is available to an innocent party where a warranty has been breached?

ANSWER

The remedy available for breach of a warranty is the award of damages only. The innocent party has no right to rescind the contract, but must carry on performing his or her obligations under the contract.

11. Explain what is meant by the *contra proferentem* rule.

ANSWER

The *contra proferentem* rule states that any ambiguities in a clause will be construed or interpreted against the person relying on the document he or she has drafted. What this means is that a person has to live with any ambiguities in the document that he or she has drafted. This rule applies when the clause is ambiguous or where other rules of language construction are not sufficient to resolve any conflict in its meaning. See *Alex Kay Pty Ltd v General Motors Acceptance Corporation* [1963] VR 458.

12. What is the purpose of awarding damages in contract law?

ANSWER

The object of awarding damages is for the injured party to receive compensation from the party responsible for the breach. The damages are not awarded to punish the defaulting party but to put the innocent party back in the position it would have occupied if the contract had been performed as intended.

13. Explain the two issues a court has to consider in looking at the question of damages?

ANSWER

The two issues a court has to consider are that the damages must not be too remote and that there is a duty on the part of the plaintiff to mitigate the loss.

14. Explain what is meant by saying that a person claiming damages must mitigate the loss. Who has the burden of proving that the damage was not mitigated?

ANSWER

This means that the law imposes a duty upon a person claiming damages to take all reasonable steps to minimise the loss (keep the loss to a minimum) caused by the breach of contract. Therefore, any damages awarded to him will not include those that have been incurred as a result of his failure to do so.

The burden of proving that there is a failure of the plaintiff to mitigate his or her loss rests with the defendant.

15. Explain briefly the rule in *Hadley v Baxendale.*

ANSWER

The rule in *Hadley v Baxendale* says that there are two kinds of loss for which the injured party can claim:

- loss occurring in the usual or normal course of things as a result of the breach, and
- loss occurring as a result of special or exceptional circumstances where such loss was made known to the offending party at the time the contract was entered into.

Any loss that does not come within either of the above categories will not give rise to an award of damages as it will be treated as being unforeseeable, or too remote. To put it another way, it will not be seen as a loss which the offending party could have contemplated as a result of the breach. Where a plaintiff wishes to recover in such a situation, he or she must put the offending party on notice of the special or exceptional circumstances that may apply. The concept underlying the principle of remoteness is that it is neither just nor practicable to hold a party in breach to be liable in damages for every conceivable loss that might arise in consequence of the breach no matter how unusual or

unexpected the consequences might be. Therefore the principle was developed that damages recoverable are limited to those that are not too remote.

16. What are liquidated and unliquidated damages?

ANSWER

Liquidated damages are damages that represent a sum specified or capable of being specified. Unliquidated damages are those damages that have not been, nor are they capable of being, specified by the use of an arithmetical formula. Claims for pain and suffering, loss of enjoyment of life etc., are clear examples of damages that are unliquidated.

PROBLEM QUESTION

Before you attempt the following problem, make sure you read the 'Guidelines for answering problems' and be acquainted with the IPAC method of writing answers to problem questions.

PROBLEM

Nancy owns Polstar Printing, which prints stationery, brochures, business cards, and other materials. In 2006 the printing press broke down and had to be repaired. Tiptop Machinery Ltd was contracted to take the printing press to its factory to have it repaired. Tiptop promised that the printing press would be returned and installed in two days.

Nancy had managed to secure a lucrative contract with the Defence Department, to print brochures to publicise its work and to recruit young people into the army. This contract required Polstar to complete the order of brochures on a date that happened to be one day after the printing press was due to be returned. The printing press was repaired and returned in seven days' time, not two days' time as promised. The officers in the Defence Department were furious at Polstar for not being able to fulfil its promise to deliver on time, and cancelled the contract. Nancy sues Tiptop for breach of contract.

ANSWER

This question has to do with the issue of the award of damages. **(Issue)**

At common law, the awarding of damages has been the traditional way of compensating an innocent party in the case of breach. The aim here is to compensate the injured party for the loss sustained by the breach and not to punish the defaulting party. For the plaintiff to succeed, it must show that the loss was not too remote (that is, it must show that the loss

was foreseeable by the defendant): *Hadley v Baxendale*—and that the defendant was made aware of the circumstances of the plaintiff: *Victoria Laundry v Newman*. **(Principle)**

Nancy did not inform TipTop of her circumstances, that is, of the fact that she had a lucrative contract with the Defence Department. The loss Nancy suffered was too remote. It was not reasonable for Tiptop to foresee that Nancy would suffer a loss as a result of this contract. **(Application)**

Nancy will not be able to sue Tiptop for damages resulting in a loss of profits from not fulfilling her obligations under the Defence Department contract. Nancy could, however, sue Tiptop for loss of profits flowing as a 'natural consequence of the breach', which is limited to the loss of profits resulting from Tiptop's failure to return the printing press in two days as promised. **(Conclusion)**