

chapter 8

Contract law 2

Learning objectives

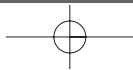
At the end of this chapter you should be able to:

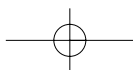
- describe the capacity of parties to contract, including:
 - minors
 - persons of unsound mind
 - intoxicated persons
 - bankrupts
- explain under what circumstances contracts made with minors will be valid, void and voidable
- explain why reality of consent must be present to form a contract
- explain what is meant by a 'common mistake', a 'mutual mistake', and a 'unilateral mistake', and describe the effect on a contract of these mistakes;
- explain the defence of *non est factum*
- define a 'misrepresentation', and distinguish an innocent misrepresentation from a fraudulent misrepresentation
- explain the effect that a misrepresentation has on the validity of a contract, and the remedies available to an injured person
- define 'duress' and describe the effect if a person has entered a contract because of it
- explain what is meant by 'undue influence' and state the relationships in which it is presumed
- define an 'unconscionable contract'
- list agreements where the element of legality of object is absent, both by statute and at common law
- explain the meaning of a 'contract in restraint of trade', and the circumstances under which such contracts will be enforceable
- describe the effect of illegality on a contract and the circumstances in which illegal terms of a contract may be severed.

Summary of contents

This chapter will cover:

- capacity of minors to contract
- contracts for necessities, and beneficial contracts of service
- voidable contracts with respect to minors
- void contracts with respect to minors
- minors' contracts in New South Wales and South Australia
- contractual capacity of the insane and intoxicated
- contractual capacity of bankrupts and corporations
- common, mutual and unilateral mistakes and their effects on contracts
- mistake as to the nature of a document (*non est factum*)
- misrepresentation
- remedies for misrepresentation
- duress
- undue influence
- unconscionable contracts
- contracts illegal at common law
- contracts in restraint of trade
- contracts illegal by statute
- severance of illegal contracts.





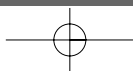
Introduction

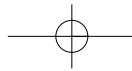
In this chapter we will consider the remaining essential elements that must be present before a valid contract can exist (the other three were discussed in Chapter 7). They are: capacity of parties, reality of consent and legality of object.

The following terms are used throughout this chapter:

bankrupt	a person against whom a declaration of bankruptcy has been made
common mistake	both parties to a contract are mistaken and they make the same mistake
duress	pressure on a person to enter a contract against their will by threatening that person, or a person close to them, with violence
fraudulent misrepresentation	a false statement of fact made knowingly or with reckless indifference to its truth or falsity
innocent misrepresentation	a false statement of fact that the statement maker believes was accurate
minor	a person under the age of eighteen years
misrepresentation	a statement of fact that is untrue
mutual mistake	both parties to a contract are mistaken but their mistakes are different
necessaries	goods and services suitable to the condition in life of a minor
ratify	to affirm
representation	statement of fact
rescission of contract	termination of a contract
unconscionable	excessively unreasonable
undue influence	where a person uses their influence over another to force the other to enter a contract
unilateral mistake	one party to a contract is mistaken and the other party to the contract knows, or ought to know, of their mistaken belief
void contract	a contract of no legal effect
voidable contract	a contract that can be set aside by one of the parties to the contract, usually the injured party

Key terminology





CAPACITY OF PARTIES

Some individuals lack capacity to contract

The fourth element required to constitute a contract is the capacity of parties. The parties to a contract require capacity or ability to contract. Figure 8.1 (see p. 42) illustrates those people who have a limited capacity to make contracts.

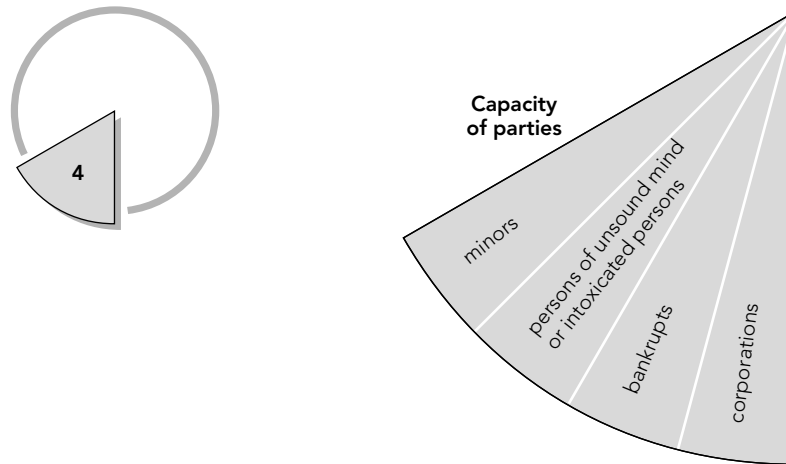


FIGURE 8.1 Persons who may have limited contractual capacity

Minors

A **minor** is any person who has not reached the age of eighteen years. Another term to describe such a person is an ‘infant’. When a minor reaches the age of eighteen years, they are said to have attained ‘the age of majority’ or to have ‘reached majority’. The age of majority in each State and Territory of Australia is eighteen years. Table 8.1 contains the titles of the relevant State and Territory legislation.

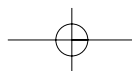
TABLE 8.1 Legislation defining the age of majority

State/Territory	Relevant legislation
New South Wales	<i>Minors (Property and Contracts) Act 1970</i>
Victoria	<i>Age of Majority Act 1977</i>
Queensland	<i>Law Reform Act 1995</i>
South Australia	<i>Age of Majority (Reduction) Act 1971</i>
Western Australia	<i>Age of Majority Act 1972</i>
Tasmania	<i>Age of Majority Act 1973</i>
Australian Capital Territory	<i>Age of Majority Act 1974</i>
Northern Territory	<i>Age of Majority Act 1974</i>

Special rules applicable to minors

The law protects minors and has developed special rules that apply to contracts made by them. The rules are predominantly common-law based, with some statutory modifications. This is so in all jurisdictions except New South Wales, where common-law principles have been completely replaced by the provisions of the *Minors (Property and Contracts) Act 1970*.

At common law, contracts made with a minor fall into one of the three categories depicted in Figure 8.2.



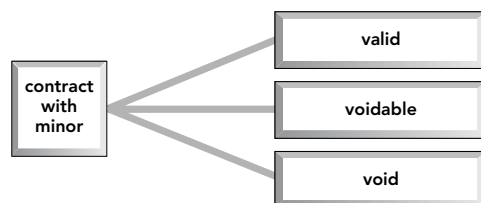


FIGURE 8.2 Three categories of contracts that can be made with minors

VALID CONTRACTS

A number of contracts that are made by minors are regarded as binding. They are:

- contracts for necessities
- beneficial contracts of service
- cash transactions.

Contracts for necessities

'Necessaries' are goods and services suitable to the 'condition in life' of a minor. The test is a subjective one: are the goods and services necessities for a particular minor? They may not be necessities for minors in general, but they may be necessities for the minor in question. They must be necessities at the time of the sale. Necessaries will include such items as food, clothing, shelter and medicine. However, they are not restricted to absolute necessities. Whether a contract is for the supply of necessities will be a question of fact in each case.

Subjective test applied

CASE EXAMPLE

Nash v. Inman [1908] 2 KB 1

Facts: The defendant, a minor, purchased a number of waistcoats from the plaintiff. The issue was whether they were necessities.

Decision: The court held that the waistcoats were not necessities as the minor had an adequate supply at the time of sale. It was held that two conditions had to be met before goods or services would be regarded as 'necessaries'. First, the goods or services had to be suitable to the condition in life of the minor (e.g. a minor accustomed to living a life of luxury will have a different 'condition in life' from a minor living in impoverished circumstances). Whether this was the case would depend on the type of lifestyle the minor in question was accustomed to leading. Second, the goods or services had to be suitable to the minor's actual requirements at the time of supply. If the minor had an adequate supply of the relevant goods from another source, this requirement would not be satisfied.



CASE EXAMPLE

Scarborough v. Sturzaker (1905) 1 Tas LR 117

Facts: A minor purchased a bicycle from the defendant.

Decision: It was held that the minor was liable on the contract. It was necessary for him to travel 12 miles (19 km) to his daily employment.

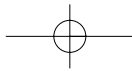


CASE EXAMPLE

Sultman v. Bond [1956] QSR 180

Facts: A minor took out a loan to finance the building of a house.





Decision: It was held that the minor was not liable on a contract for the building of a house. The loan repayments imposed too much of a burden on the minor.



CASE EXAMPLE

Bojczuk v. Gregorcowicz [1961] SASR 128

Facts: A minor living in Poland was lent some money by a relative who paid for her passage to emigrate from Poland to Australia. The minor subsequently reneged on her promise and the plaintiff sued to recover the money that had been lent.

Decision: The court held that migrating to Australia and the accompanying benefits did not amount to a conferral of the necessities of life upon her. The minor did not have to repay the money that was lent. The court said that the minor did not come to Australia for the purpose of providing herself with a means of support, as she had a satisfactory job in Poland.

Beneficial contracts of service

Education, employment
or instruction

Contracts that are beneficial to the minor—in the sense that they provide some form of education, employment or instruction—will be binding. A contract of apprenticeship falls into this category.



CASE EXAMPLE

Roberts v. Gray [1913] 1 KB 520

Facts: The defendant, a minor, agreed to take part in a world billiard-playing tour with other professional players.

Decision: The court held that the contract was of a beneficial nature as the minor would obtain exposure, experience and instruction. This would assist the minor in his intended career as a professional billiard player.



CASE EXAMPLE

McLaughlin v. Darcy (1918) 18 SR (NSW) 585

Facts: The defendant, a minor, made a contract to secure a passport. The minor wished to go to the United States of America to pursue a professional boxing career.

Decision: A contract to secure a passport was regarded as beneficial and binding on the minor.

Whole contract must
be considered

In determining whether a contract is beneficial, the whole of the contract must be considered. The whole of the contract must be beneficial before it can be regarded as binding on the minor.

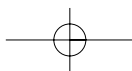


CASE EXAMPLE

Corn v. Matthews [1893] 1 QB 310

Facts: A contract of apprenticeship provided that an employer could withhold wages from a minor during a strike by workers. It gave the minor an option to work elsewhere during such a strike.

Decision: The court held that this was not a beneficial contract as the whole of the contract was not beneficial to the minor. In particular, the provisions regarding strikes were not beneficial.



Cash transactions

Minors who pay **cash** for goods or services will be bound by the contract. This is so even if the contract is not for the purchase of necessities or is not a beneficial contract of service. If no price has been agreed on by the parties, the minor is obliged to pay a reasonable price.

Figure 8.3 summarises the types of contract that bind minors.

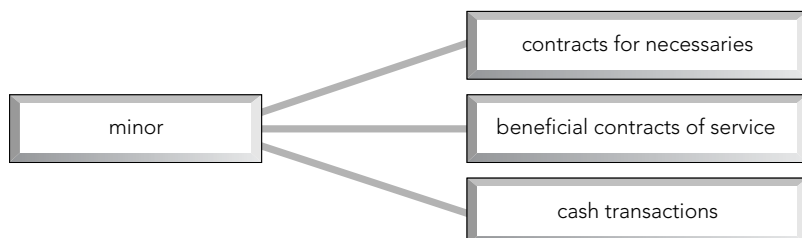


FIGURE 8.3 The types of contract that bind minors

VOIDABLE CONTRACTS

A contract made with a minor that is not for necessities or is not a beneficial contract of service may be voidable. At common law, there are two types of contract that fall into this category. First, contracts that will be **binding** on a minor during their majority, unless **repudiated** by the minor during their minority or within a reasonable time of attaining their majority, are voidable. To ‘repudiate a contract’ means to reject it and to decide not to be bound by it.

The second type of contract is that which is **not binding** on the minor unless **ratified** (affirmed) by the minor within a reasonable time of attaining the age of majority.

Contracts binding unless repudiated

Contracts that fall into this category are those involving continuing obligations. They are contracts of a permanent nature (e.g. contracts involving land, leases or partnerships, or contracts for the purchase of shares in a company). A minor will be bound by these contracts unless specific steps are taken to repudiate (rescind) the contract during their minority or within a reasonable time of attaining the age of eighteen years. Generally, if a benefit has been obtained by the minor, a refund of purchase moneys cannot be obtained.

CASE EXAMPLE

Steinberg v. Scala (Leeds) Limited [1923] 2 Ch 452

Facts: The plaintiff (a minor) applied for shares in the defendant company. After they had been allotted to her, she tried to repudiate the contract.

Decision: She was unable to recover the money she had paid for the shares. She had received the shares for which she had contracted, and thus the money was not recoverable.

Contracts not binding unless ratified

Contracts falling into this category are those that are not of a continuing nature. These contracts will not bind a minor unless the minor ratifies (affirms) the contract within a reasonable time of attaining the age of majority. A contract for the supply of goods that are not necessities would fall into this category.

The common-law principles in relation to voidable contracts have been modified by statutes. In Victoria and Tasmania, contracts of this nature are rendered void and incapable of

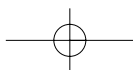
Minors bound by cash transactions

Attaining the age of majority

Contracts of a permanent nature



Common law modified by statutes



being ratified by the minor on attaining the age of majority. In New South Wales and South Australia, legislation that deals with a minor's capacity to contract has been enacted. This legislation will be discussed later in this chapter.

VOID CONTRACTS

Minor's liability for loans
and cheques

At common law, contracts made with a minor that are not valid will be voidable or void. In all States, a minor is not liable on a contract to repay moneys lent on security, even if the loan has been given for the purchase of necessaries. In addition, a minor is not liable on a cheque or bill of exchange, even if given for the price of necessaries. Legislation in Victoria modifies the common law stated above. The following contracts are regarded as 'absolutely void' when made with a minor:

- contracts for the repayment of money lent
- contracts for the payment of goods supplied or to be supplied (other than those for necessaries)
- all 'accounts stated' (an account stated is an admission of a sum of money being due from one person to another).

These contracts cannot be enforced against a minor. It is possible for the minor to voluntarily pay back a loan, but the other party cannot force the minor to do so.

TORTS COMMITTED BY MINORS IN CONNECTION WITH A CONTRACT

Torts connected with contracts

As a general rule, minors are liable for the torts they commit. However, a minor is generally not liable for a tort connected with a contract. A minor will be liable for a tort, however, where the act that is committed is not contemplated by the parties when they enter the contract.



CASE EXAMPLE

Burnard v. Haggis (1863) 14 CB (NS) 45

Facts: A minor hired a horse expressly for riding and not for jumping, and then lent it to a friend who killed it by using it for jumping.

Decision: The minor was held liable for this tort.

Modification of common law

In New South Wales, the common-law rules above have been modified by the provisions of the *Minors (Property and Contracts) Act 1970*. This Act provides that if an infant is guilty of a tort, he is answerable for the tort whether or not the tort is connected with a contract.

MINORS' CONTRACTS IN NEW SOUTH WALES

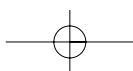
Minors bound by 'civil acts'

The contractual capacity of minors in New South Wales is governed by the *Minors (Property and Contracts) Act 1970*. This Act provides that minors will be bound by 'civil acts' once they reach the age of eighteen years. A **civil act** is defined to include any act relating to contractual or proprietary rights or obligations, or to any chose in action. If the minor participates in such an act during their minority and the act is for the 'benefit' of the minor, it will be regarded as **presumptively binding**. This means that the contract will bind the minor. A minor may escape liability by alleging fraud or duress.

Age and position in life
of a minor

In determining whether a contract benefits the minor, the whole contract needs to be considered. The age and position in life of the particular minor will be relevant in determining the validity of a contract.

Section 30 of the Act provides that on attaining eighteen years, a minor can affirm a civil act. In addition, it is possible for a court to affirm such an act before the minor attains eighteen years. This can be done on the application of the minor or the other party to the contract.



MINORS' CONTRACTS IN SOUTH AUSTRALIA

The common law regarding minors' contracts in South Australia has been modified by the provisions of the *Minor's Contracts (Miscellaneous Provisions) Act 1979*. The major alterations made by this Act are in relation to minors' contracts regarded as voidable at common law. They are:

- contracts binding unless repudiated by an infant during minority or within a reasonable time of attaining majority
- contracts not binding unless ratified by the minor within a reasonable time of attaining majority.

Under the *Minor's Contracts (Miscellaneous Provisions) Act*, any contract that would have been regarded as voidable at common law (i.e. a contract falling within one of the above-mentioned categories) is regarded as **unenforceable**. The contract will not bind a minor unless the minor ratifies the contract (in writing) on or after the day on which the minor attains the age of majority. The effect is that in South Australia, the common-law distinction between the two categories of voidable contracts (mentioned above) has now been removed.

Another important provision of the South Australian Act is in relation to guarantees. A person who guarantees a minor's contractual obligations will be bound by that guarantee, as if the minor had been an adult when making the contract that establishes liability. Section 7 gives discretion to the court to order restitution of property in relation to a contract that a minor has repudiated. The Act modifies the common law rule that a minor who obtains a benefit from the contract is not entitled to a refund of moneys paid.

Another important provision of the Act enables the court, on application by a minor or a parent or guardian of a minor, to appoint a person to transact business or to execute any documents for a minor.

Table 8.2 contains the names of each piece of legislation in Australia that modifies the common law rules relating to minors.

TABLE 8.2 Legislation modifying the common law rules relating to the capacity of minors to contract

State/Territory	Relevant legislation
New South Wales	<i>Minors (Property and Contracts) Act 1970</i>
Victoria	<i>Supreme Court Act 1986</i>
Queensland	<i>Statute of Frauds 1972</i>
South Australia	<i>Minor's Contracts (Miscellaneous Provisions) Act 1979</i>
Western Australia	<i>Statute of Frauds (Amendment) Act 1828 (UK)</i>
Tasmania	<i>Minors Contracts Act 1988</i>
Australian Capital Territory	<i>Mercantile Law Act 1962</i>
Northern Territory	<i>Statute of Frauds (Amendment) Act 1828 (UK)</i>

In Western Australia and the Northern Territory, the United Kingdom statute continues to form part of the law received by both jurisdictions.

Check your progress 8.1

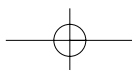
Place a tick in the appropriate box.

1. Which type of contract is not binding on minors?
 - (a) a contract for the repayment of money lent
 - (b) a contract for the supply of necessaries
 - (c) a beneficial contract of service
 - (d) a cash transaction

Certain contracts
are unenforceable



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2. A contract that provides a minor with some form of education or employment is a:
 - (a) contract for necessities
 - (b) beneficial contract of service
 - (c) voidable contract
3. A contract that will be binding on a minor during their majority, unless repudiated by the minor during their majority, is an example of:
 - (a) a voidable contract
 - (b) a void contract
 - (c) an unenforceable contract
4. A minor who enters into a contract to repay money is:
 - (a) liable to repay any money borrowed
 - (b) only liable to repay money borrowed to purchase necessities
 - (c) never liable to repay the money
5. A minor will generally not be considered liable for a tort connected with a contract.
 - (a) True
 - (b) False
6. In New South Wales, minors who benefit from contracts that they have made will be regarded as bound by the contract.
 - (a) True
 - (b) False
7. In South Australia a person who guarantees a minor's contractual obligations will be bound by that guarantee.
 - (a) True
 - (b) False

Persons of unsound mind and intoxicated persons

Limited capacity

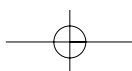
Persons of unsound mind and intoxicated persons have a limited capacity to make contracts. The law seeks to protect persons who may enter agreements and not understand the nature of the obligations imposed on them because of their state of mind.

Mental guardianship legislation

Mental guardianship legislation has been enacted by each State and Territory. Table 8.3 contains the main legislation in each jurisdiction. It is important to recognise that a combination of statute law and common-law rules regulates the legal capacity of persons of unsound mind to enter into contracts.

TABLE 8.3 State and Territory mental guardianship legislation

State/Territory	Relevant legislation
New South Wales	<i>Protected Estates Act 1983</i>
Victoria	<i>Guardianship and Administration Board Act 1986</i>
Queensland	<i>Mental Health Act 1974</i>
South Australia	<i>Mental Health Act 1993</i>
Western Australia	<i>Mental Health Act 1996</i>
Tasmania	<i>Mental Health Act 1963</i>
Australian Capital Territory	<i>Guardianship and Management of Property Act 1991</i>
Northern Territory	<i>Adult Guardianship Act 1988</i>



A person who is of unsound mind, or intoxicated because of alcohol or other drugs, will be bound by a contract unless two matters can be proved:

1. that the impaired person did not understand what they were doing because of the condition they were in
2. that the person with whom the impaired person was contracting knew of the impaired person's condition.

If these matters are proved, a contract is voidable at the option of the impaired person. The onus of proof rests on the intoxicated or mentally ill person. It is necessary for the impaired person to repudiate the contract within a reasonable time of becoming sober or sane.

Contract voidable under certain circumstances

CASE EXAMPLE

York Glass Co. Ltd v. Jubb [1925] All ER Rep 285

Facts: Jubb contracted to purchase the plaintiff's company business. On the date of contracting, he was technically insane and shortly thereafter was placed in a lunatic asylum. The receiver of his estate, who was appointed under a lunacy statute, repudiated the contract. The plaintiff company sued for damages, alleging the repudiation was wrongful.

Decision: The court held that a contract entered by someone of unsound mind is valid unless the impaired person can show that the other party was aware, at the time of contracting, that the impaired person was so insane that he was incapable of understanding what he was doing. In this case, there was no evidence to show that the plaintiff company knew or suspected that Jubb had been insane at the point of contracting. The contract was valid and Jubb's estate had to pay damages for not performing the contract.



CASE EXAMPLE

Gibbons v. Wright (1954) 91 CLR 423

Decision: It was held that if a mentally incapacitated person or an intoxicated person confirmed a contract on becoming sane or sober, then the person could not subsequently refuse to be bound by it on the grounds of unsoundness of mind or intoxication.

Conversely, it is possible for an intoxicated or mentally ill person to ratify the contract they have entered while incapacitated. This can be done once sanity or sobriety returns. If this course of action is chosen then it not possible at a later time for the contract to be rescinded. This is illustrated by the following case example.



CASE EXAMPLE

Matthews v. Baxter (1873) LR 8 Exch 132

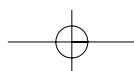
Facts: Baxter, while drunk, agreed at an auction to purchase a property. Once sobriety returned he decided that he wished to affirm the contract that had been made by him while drunk. Some time later he had a change of mind and he sought to rescind the contract, arguing that he lacked capacity to enter the contract by reason of intoxication.

Decision: The court held that because Baxter had confirmed the contract it was no longer open to him to avoid the contract on the grounds of intoxication. This was despite the fact that he had made out the necessary element of this defence.



In each jurisdiction, the sale of goods statutes set out in Table 8.4 (p. 50) provide that mentally incapable persons or intoxicated persons will be liable to pay a **reasonable price** for the sale of necessities supplied to them while they are contractually disabled. The term 'necessaries' has the same meaning as when used in the context of minors' contracts.

Sale of goods legislation



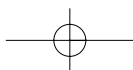


TABLE 8.4 Sale of goods statutes imposing obligations on mentally incapacitated and intoxicated persons

State/Territory	Relevant legislation
New South Wales	<i>Sale of Goods Act 1923</i>
Victoria	<i>Goods Act 1958</i>
Queensland	<i>Sale of Goods Act 1896</i>
South Australia	<i>Sale of Goods Act 1895</i>
Western Australia	<i>Sale of Goods Act 1895</i>
Tasmania	<i>Sale of Goods Act 1896</i>
Australian Capital Territory	<i>Sale of Goods Act 1954</i>
Northern Territory	<i>Sale of Goods Act 1972</i>

Bankrupts

A declaration of bankruptcy does not remove an individual's contractual capacity. However, the *Bankruptcy Act 1966* (Cwlth) provides that in certain cases, bankrupts must disclose their bankruptcy prior to entering a contract. A bankrupt who proposes to obtain credit in excess of \$3000 must disclose the fact that they are an undischarged bankrupt. Disclosure is also required if a bankrupt is trading under a firm or under an assumed name. The penalty for failure to disclose is up to three years' imprisonment (s. 269).

Section 269 also provides that an undischarged bankrupt may not carry on business under an assumed name without disclosing to the persons with whom they deal that they are an undischarged bankrupt.

A person who contracts knowingly with an undisclosed bankrupt should be cautious because the contract may not be binding on the trustee in bankruptcy. The trustee may intervene and disclaim the contract. Chapter 20 contains a more detailed discussion of bankruptcy law.

Corporations

A corporation is regarded by the law as a legal entity capable of suing, being sued and owning property. Unlike a natural person, it is an artificial legal entity. It only has the power to contract through individuals. Corporations have the same power to contract as natural persons as long as the person making the contract on behalf of the company has authority to contract.

At common law, contracts entered on behalf of a company not yet incorporated cannot be ratified by the company once incorporated. The *Corporations Law* remedied this position.

A married woman

Historically, at common law, a married woman was regarded as having no contractual capacity. She was not regarded as having a separate personality from her husband. Statutes in each jurisdiction have now given married women contractual capacity. Today, a married woman has the same legal capacity as that of a man or a single woman.

REALITY OF CONSENT

Reality of consent is the fifth element required to constitute a contract. The reasons why this element may be absent are set out in Figure 8.4.

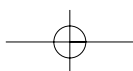
Disclosure requirements

Discussion question

Do you think an undischarged bankrupt should have the capacity to contract? Give reasons for your answer.

Individuals may contract on corporation's behalf

Full contractual capacity



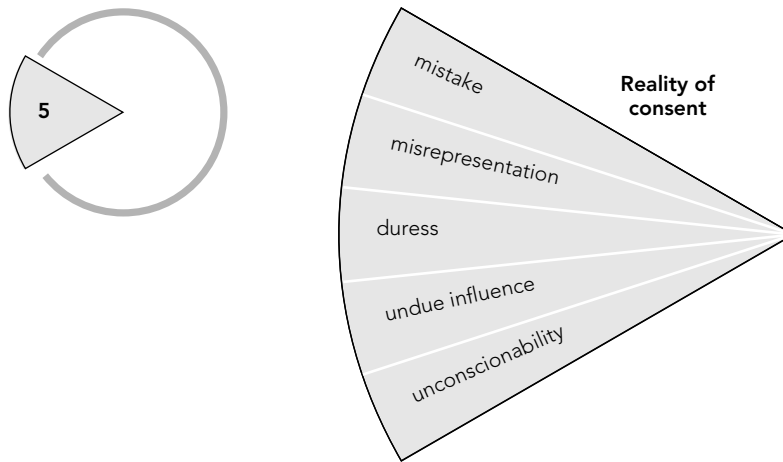
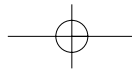


FIGURE 8.4 Reasons why reality of consent may be absent

When parties enter an agreement, their consent must be genuine. If an agreement is reached because of a mistake, misrepresentation, duress, undue influence or unconscionability, the injured person may be entitled to rescind the contract. The basis for rescission is that reality of consent is absent. We will now consider the circumstances where the law provides that there is no genuine consent between the parties to an agreement—the situations where the law says reality of consent is absent.

Genuine consent required

Mistake

A party may enter an agreement under a mistaken belief. Certain mistakes will render a contract void. Mistakes can be divided into two broad categories: mistakes of law and mistakes of fact. A mistake made by a person about a legal right or obligation is a mistake of law and it will not render a contract void. The reason for this is that everyone is presumed to know what the law is. The expression ‘ignorance of the law is no excuse’ is correct.

Mistake of fact and law

LAW IN ACTION

Belinda believes the speed limit on a suburban road is 80 km/h. In fact, it is 60 km/h. This mistake could not be raised by Belinda as a defence to a charge of exceeding the speed limit.

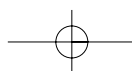


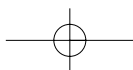
TABLE 8.5 Types of mistake	
Mistake	Effect
Common mistake	Contract may be void at common law or voidable at equity
Mutual mistake	Contract void
Unilateral mistake	Contract may be void/voidable
<i>Non est factum</i>	Contract may be void/voidable

A mistake must be distinguished from an error of judgment. Such an error will not enable a person to escape the liabilities of a contract.

LAW IN ACTION

Anne purchases an antique table believing it is worth \$10 000, when it is worth only \$2000. She will not be entitled to avoid the contract and get a refund of her money.





Mistake will render the contract void or voidable

Some mistakes of fact will render a contract void. The contract is regarded as void *ab initio*—a Latin expression meaning ‘from the beginning’. The law is saying that no contract ever existed. The law is reluctant to avoid contracts based on a mistake because it does not wish to encourage fraudulent or false claims of mistake.

Mistakes are classified by the law into three groups: common, mutual and unilateral mistakes.

COMMON MISTAKE

A common mistake occurs when both parties are mistaken and they make the same mistake.



EXAMPLE

Rebecca and Peter agree to sell their Holden car to Mandy and Phillip. At the time the contract is made, unbeknown to them all, the car has been destroyed by fire. Both the parties believed that the subject matter of the contract existed; they were mistaken.

Mistakes as to the existence of the subject matter

Not all common mistakes will render a contract void. The law restricts this to mistakes as to the existence of the subject matter of the contract or the existence of a fact fundamental to the contract. If the parties to a contract believe the subject matter exists at the time of contracting, but in fact the subject matter did not exist, then the contract may be avoided.



CASE EXAMPLE

Galloway v. Galloway (1914) 30 TLR 531

Facts: Mr and Mrs Galloway believed that they were lawfully married and they entered a deed of separation. In fact, when they married, Mr Galloway’s first wife was still alive, unbeknown to Mr Galloway. When Mr Galloway fell into arrears making payments pursuant to the deed, ‘Mrs Galloway’ sued him. He argued that the deed was void, as it had been entered on a mistaken belief—that is, that they were lawfully married and that he was obliged to support his wife and three children.

Decision: The deed was void on the ground that the ‘marriage’ (the basis or fact on which the deed was made) never existed. ‘Mrs Galloway’ therefore could not sue for payment under it, because in law it never existed.



CASE EXAMPLE

Prichard v. Merchant’s and Tradesman’s Mutual Life Assurance Society (1858) 3 CBNS 622

Facts: A life insurance policy had been taken out on the life of a person. The beneficiary paid a premium to renew the policy. At the time, neither the insurer nor the beneficiary was aware that the assured had died. Both parties mistakenly believed the assured was alive. The beneficiary sought to recover the renewal premium.

Decision: The court held that the contract was void due to a common mistake. The mistake was about a fact fundamental to the contract (i.e. that the assured was alive). The beneficiary was able to recover the payment of the premium.

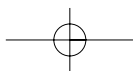
In cases where the courts can imply from the conduct of the parties a promise that the subject matter does exist, the contract will be valid.



CASE EXAMPLE

McRae v. Commonwealth Disposals Commission (1951) 84 CLR 377

Facts: The defendant advertised for tenders to salvage an oil tanker lying on the Jourmand Reef near Samarai (in Papua New Guinea). McRae was successful in obtaining the tender



and entered a contract for the salvage of 'an oil tanker ... wrecked on Jourmand Reef ... 100 miles [161 km] north of Samarai'. The plaintiff mounted a salvage expedition but could not locate the tanker. In fact, the tanker did not exist. McRae sued for damages and the defendant argued that there had been a common mistake and the contract was void. The defendant argued that the plaintiff had no entitlement to damages for breach of contract.

Decision: The High Court of Australia held that there was no common mistake. The conduct of the defendant implied that a promise had been made to McRae that the vessel existed.

If a contract has been entered as a result of a common mistake that is not about a fact fundamental to the contract or regarding the existence of subject matter, the contract will not be void at common law. It is possible, however, for the courts applying equitable principles to declare the contract voidable. This may occur if both parties are mistaken and the mistake is regarding something such as the quality or value of the subject matter.

Application of
equitable principles

CASE EXAMPLE

Solle v. Butcher [1950] 1 KB 671

Facts: Butcher leased a flat to Solle at an annual rental of £250. When the contract was made, both parties believed the flat was not subject to the *Rent Restrictions Acts* of 1920 and 1923 (UK). The legislation did apply and the maximum permissible rental was £140 per annum. The tenant had been in possession for two years before he discovered this and he then sued Butcher, seeking repayment of the excessive rent and a declaration that he could remain in the flat for the remaining five years of the lease at the lower rental. Butcher argued that the contract was void because of a common mistake (i.e. both thought the Acts did not apply when in fact they did).

Decision: The court said the contract was not void for common mistake but that it was voidable.



MUTUAL MISTAKE

A mutual mistake occurs when both parties are mistaken but their mistakes are different.

EXAMPLE

Karl offers to sell his Holden car to Claire, and Claire believes she is buying Karl's Ford car.

If such a mistake occurs, the existence of a contract depends on whether there has been a meeting of minds, a real offer, and acceptance. The courts have said that this question needs to be asked: would a reasonable person say that a contract existed?



Reasonable person test

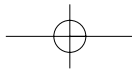
CASE EXAMPLE

Raffles v. Wichelhaus (1864) 2 H & C 906; 159 ER 375

Facts: The defendant agreed to purchase cotton, to arrive from Bombay on the liner *Peerless*. There were two ships called *Peerless*, one sailing in October and the other in December. The plaintiff's offer was with respect to the December sailing, whereas the defendant's acceptance was for the October sailing. The October sailing was critical to the defendant's decision to enter the contract.

Decision: The court held that there was no binding contract because each party intended to contract with respect to a different ship. There was no meeting of minds, no real offer and acceptance, and therefore the contract was void. A reasonable person would not say that a contract existed.





UNILATERAL MISTAKE

Contract may be avoided

A unilateral mistake occurs when one party to the contract is mistaken and the other party to the contract knows, or ought to know, of their mistaken belief. At common law, it may be possible to avoid a contract because of a unilateral mistake if it can be shown that the mistake was regarding a matter fundamental to the contract. It is possible to identify three separate categories of unilateral mistake:

- a unilateral mistake as to the **terms** of a contract
- a unilateral mistake as to the **identity** of one of the contracting parties
- a unilateral mistake as to the **nature** of the document being signed.

Unilateral mistake as to the terms of a contract

At common law, historically, if a party were mistaken as to the terms of an offer or an acceptance, and this mistaken belief was known or should have been known to the other party, the contract would be regarded as void.



CASE EXAMPLE

Hartog v. Colin & Shields [1939] 3 All ER 566

Facts: The parties made a contract to buy and sell a quantity of Argentine hare skins. In negotiations leading up to the making of the contract, the parties had negotiated on the basis of a price per piece. The last price stated by the plaintiff (the buyer) during negotiations was 10s per piece. In response, the defendant made an offer to sell at 10 1/4s per pound (as opposed to per piece). The plaintiff accepted this offer. The defendant then refused to deliver at that price and the plaintiff sued the defendant for non-delivery.

The defendant claimed that there was no contract because of the defendant's mistake. The defendant argued that the plaintiff should have known of the mistake.

Decision: The court said that there was no contract between the parties, and that the plaintiff was not entitled to damages for non-delivery. The court found that the word 'pound' had been mistakenly used instead of the word 'piece', and that this mistake was, or should have been, apparent to the plaintiff. The contract was regarded as void.

Relief from the law of equity

The following Australian decision also deals with the concept of a unilateral mistake. In this case, the common law did not provide relief but the law of equity did. This case seems hard to reconcile with the decision in *Hartog v. Colin & Shields*.



CASE EXAMPLE

Taylor v. Johnson (1983) 151 CLR 422

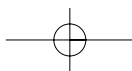
Facts: The parties made a contract for the sale and purchase of 10 acres (4 ha) of land for a purchase price of \$15 000. The seller claimed that the contract was for \$15 000 per acre rather than \$15 000 total. She refused to complete the sale. The purchasers sued for breach of contract, claiming the remedy of specific performance.

Decision: The court considered that the contract could be rescinded in equity. However, the court did not find the contract void at common law on the basis of a unilateral mistake. The reason why the court refused to set aside the contract at common law was that if a reasonable third party had witnessed the agreement, the court would honestly believe that the parties had agreed to the same thing upon the same terms.

Unilateral mistake as to identity

Offeror must be identified

A person may be mistaken about the identity of the person with whom they are entering a contract. As Figure 8.5 illustrates, a person may think that they are dealing with a particular person, but in fact that person is someone else.



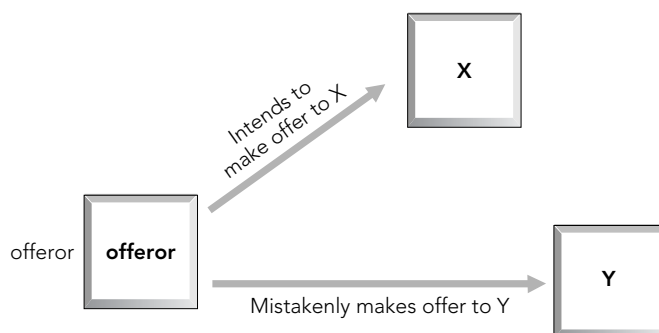


FIGURE 8.5 Mistake as to identity

The common law may regard the resulting contract as void if the offeror can prove a number of things. The offeror must prove that:

- the offer made was intended for person X and that X's identity was very important
- reasonable steps were taken to ensure X was the person dealt with
- the person with whom the offeror was dealing was aware, or should have been aware, of the intentions of the offeror.

EXAMPLE

Alexander contracts with Bruce. He believes Bruce is Craig. It is imperative that Alexander contracts with Craig. If Bruce knows of this mistaken belief, and fails to inform Alexander of his mistaken belief, it may be possible to set aside the contract.

It will not be sufficient to have a contract set aside on the basis of a unilateral mistake if the offeror is simply mistaken about some attribute that they believe the offeree may possess. An example of an attribute a person may possess is creditworthiness. A mistake regarding a person's creditworthiness is a different type of mistake from a mistake about a person's identity. The distinction is illustrated by the following cases.

CASE EXAMPLE

Cundy v. Lindsay (1878) 3 App Cas 459

Facts: The plaintiff received an order for a quantity of handkerchiefs from Blenkarn, who had his address at 37 Wood Street, Cheapside. The order was signed in a way that indicated it came from 'Blenkiron & Company', who were a reputable firm carrying on business at 123 Wood Street, Cheapside. The order was filled by the plaintiff and addressed to 'Blenkiron & Company, 37 Wood Street, Cheapside'. Blenkarn received the order. He sold a large quantity of handkerchiefs to the defendant and then left without paying the plaintiff's account. When the plaintiff discovered the true state of affairs, he sued the defendant in the tort of conversion. (See Chapter 3 for a discussion of the tort of conversion.)

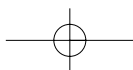
Decision: The court held that there was no contract with Blenkarn. This was because the plaintiff had only intended to deal with Blenkiron & Company and this fact must have been known to Blenkarn. Because there was no contract with Blenkarn, he did not obtain a good title to the goods and therefore could not pass a good title to the defendant. The defendant therefore was in possession of goods he did not own and was therefore liable in the tort of conversion.

In this case, the mistake was a unilateral mistake. The plaintiff was mistaken about the identity of the person with whom he was dealing. He thought he was dealing with Blenkiron & Company, not Blenkarn.



Mistake as to attribute of person





The next case is an example of a mistake, not about the identity of the other contracting party, but about an attribute possessed by the party (i.e. creditworthiness).



CASE EXAMPLE

King's Norton Metal Co. v. Edridge, Merrett & Co. Ltd (1897) 14 TLR 98

Facts: The plaintiffs received an order from 'Hallam & Co.' for the supply of a quantity of wire. The letterhead contained a picture of a large factory and a statement to the effect that the company had branches at a number of locations. In fact, Hallam & Co. did not exist. It was a company invented by a rogue called Wallis. The plaintiffs, relying on the impression given by the letterhead, supplied the goods ordered and Wallis then sold the goods to the defendants. Wallis disappeared without paying for the goods, and when the plaintiffs discovered the true facts, they sued the defendants in the tort of conversion.

Decision: The court held that the defendants were not liable. The court decided that the plaintiffs had intended to contract with the writer of the letter, and that person was Wallis. A contract existed, therefore, between the plaintiffs and Wallis. Wallis obtained a good title to the goods and was therefore able to pass a good title to the defendants. The defendants were the true owners of the goods and therefore not liable in the tort of conversion.

Reasonable steps to ascertain
true identity

Dealing face to face

It is necessary to show that the offeror (who alleges a unilateral mistake) took reasonable steps to ensure that they were dealing with the intended person. A failure to take reasonable steps to ascertain the true identity of the person with whom an offeror is dealing will prevent a contract from being set aside. If an offeror is dealing with a person face to face, the law presumes that the offeror intends to deal with that person. This presumption can be rebutted. This can be done if the offeror can show that there was no intention to deal with the party actually dealt with and that reasonable steps were taken to ensure that the offeror dealt with the party intended.

There are a number of cases dealing with this issue. Some seem hard to reconcile.



CASE EXAMPLE

Phillips v. Brooks Ltd [1919] 2 KB 243

Facts: A rogue called North went to the plaintiff's jewellery shop and selected an emerald ring and some pearls. He wrote a cheque to pay for the items, claiming he was Sir George Bullough. The plaintiff checked the address given by North in a business directory, and this corresponded with Bullough's address. The plaintiff asked North if he would like to take the items with him and North replied that he wanted to wait until the cheque was cleared but that he would take the ring, as it was his wife's birthday. North took the ring and later pawned it with the defendant. The plaintiff sued the pawnbroker for the return of the ring.

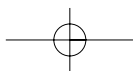
Decision: Good title in the ring had passed to the pawnbroker, and the jeweller could not recover. The jeweller claimed that he had only intended to deal with Sir George Bullough. The court held that his true intention had been to deal with the person who was physically present in the shop. The court said that the jeweller was not concerned so much with the identity of the customer, but with an attribute of the customer—creditworthiness.



CASE EXAMPLE

Ingram v. Little [1961] 1 QB 31

Facts: Two sisters, Elsie and Hilda Ingram, advertised to sell a car. A man, claiming he was 'Hutchinson', approached them. He took the car for a test drive and the women agreed to sell the car to him for £717. He wished to pay by cheque. When he produced a cheque book, Elsie said she didn't wish to proceed with the sale unless it was in cash. Hutchinson then claimed he was P. G. M. Hutchinson, that he had business interests in Guildford, and that he lived at Stanstead Road, Caterham. While negotiations proceeded, Hilda slipped out, went to a local post office and consulted a telephone directory. She verified that P. G.



M. Hutchinson lived at the Caterham address. On the basis of this, the sisters accepted the cheque. Subsequently, the cheque was dishonoured and the plaintiffs attempted to find Hutchinson. They could not. Seeking to recover the car, they sued Little who had purchased the car from Hutchinson.

Decision: The sisters were entitled to recover the car. The court said that they intended their offer only for P. G. M. Hutchinson. They had intended to deal with the person physically before them. This had not been the case when the cheque book had been produced and Elsie had refused to deal. The identity of Hutchinson had been critical.

The following decision seems very hard to reconcile with the decision in *Ingram v. Little*. In fact the court, in the following case, criticised the decision in *Ingram v. Little*.

CASE EXAMPLE

Lewis v. Averay [1972] 1 QB 198

Facts: Lewis advertised his motor vehicle for sale and was approached by a rogue claiming to be Richard Greene, a well-known film actor. They agreed on a price and a cheque was written out by the rogue, who signed it 'R. A. Greene'. Lewis asked for proof of identity from 'Greene' and was shown a special admission pass to Pinewood Studios containing his photo and the name Richard A. Greene. Lewis parted with possession of the car. The rogue subsequently misrepresented himself as Lewis and sold the car to Averay. When the cheque (written by the rogue) was dishonoured, the real Lewis sued Averay, seeking return of the vehicle or, alternatively, its value.

Decision: Lewis's action failed. The court said that the contract was not void but only voidable in equity. The court said that Lewis had passed good title to the rogue, and that Averay had bought the car in good faith with no notice of the defect in title and had received a good title.

The above case seems to reflect the modern position that such a circumstance would be voidable in equity and not void at common law for mistake.

Mistake as to the nature of a document

A person who signs a written document and is mistaken as to the nature of the document may be able to rely on a defence called *non est factum*. This Latin expression, translated literally, means 'it is not his deed'. Two conditions must be satisfied before this defence can be made out:

- The person must believe the document they signed to be **radically and fundamentally different** from the actual document signed. For example, a person believes that they are signing a mortgage document evidencing a loan in respect of land, when in fact they are signing a document that transfers their interest in land to another person.
- There must be an absence of negligence or carelessness in the execution of the document. If a person has the opportunity and the ability to read the document, or to have the document read out, and advantage is not taken of this, then this would amount to carelessness and the person may not succeed in relying on the defence. The person seeking to make out the defence has the onus of proving that they were not careless.

CASE EXAMPLE

Foster v. Mackinnon (1869) LR 4 CP 704

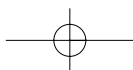
Facts: An elderly person with bad eyesight was forced to endorse a bill of exchange. The person was told that the document was a guarantee. He usually signed guarantees on behalf of a company.

Decision: The person was not liable on the document. A guarantee and a bill of exchange are fundamentally different documents. The defence of *non est factum* was successfully raised.



Defence of *non est factum*



**CASE EXAMPLE***Petelin v. Cullen* (1975) 132 CLR 355

Facts: Petelin spoke little English and could not read English at all. He signed a document that he thought was a receipt for the payment of money when in fact it was an extension of an option to purchase his land. Originally, the option to purchase had been granted to Cullen who was acting as an agent for a developer. Cullen paid an amount of \$50 for the option, which was required to be exercised within a period of six months.

The six-month period expired without the option being exercised. Petelin received another cheque for \$50. Cullen confronted Petelin at a later date and was asked to sign a document, which he was told was an acknowledgement of the receipt of the second payment of \$50. The document was not a receipt but an extension of the option to purchase. The option was in fact exercised during the extended period. An action was brought for specific performance of the option and Petelin relied on the defence of *non est factum*.

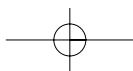
Decision: The court held that the plea of *non est factum* had been made out and refused to make an order for specific performance of the option. The document that had been signed was fundamentally different from the one Petelin believed he was signing. The court said the issue of negligence did not arise as there was no innocent third party involved. Cullen was acting as agent for the prospective purchaser and therefore they were regarded as one person.

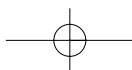
Check your progress 8.2

Interactive version at
www.mhhe.com/au/barron

Place a tick in the appropriate box.

1. Mentally incapable persons or intoxicated persons who have necessities supplied to them while they are contractually disabled:
 - (a) will not be bound by the contract
 - (b) may keep the necessities without providing consideration
 - (c) will be liable to pay a reasonable price for the necessities
2. A person must disclose that they are an undischarged bankrupt before they contract if they seek to obtain credit in excess of:
 - (a) \$3000
 - (b) \$500
 - (c) \$5000
3. The major categories of mistakes recognised by the law are:
 - (a) common and unilateral mistakes
 - (b) common, mutual and bilateral mistakes
 - (c) common, mutual and unilateral mistakes
4. A mistake that involves both parties acting under different mistakes is a:
 - (a) mutual mistake
 - (b) common mistake
 - (c) bilateral mistake
5. A unilateral mistake may relate to the identity of the person with whom a party is entering into a contract.
 - (a) True
 - (b) False
6. A unilateral mistake as to the attributes of a party to the contract will be sufficient to have the contract set aside.
 - (a) True
 - (b) False





7. The defence of *non est factum* can be raised where there has been a:

- (a) mistake as to consideration
- (b) mistake as to jurisdiction
- (c) mistake as to the nature of the document

Misrepresentation

Reality of consent will be absent from a contract that has been entered due to a misrepresentation. A **representation** is a statement of fact. A **misrepresentation** is a statement of fact that is untrue. The remedy available to a person who has been subjected to a misrepresentation varies depending on the type of misrepresentation. The three types of misrepresentation are contained in Table 8.6. A person induced to enter a contract due to a fraudulent misrepresentation can rescind the contract and claim damages. A party induced to enter a contract by an innocent misrepresentation may, pursuant to statute or in equity, rescind the contract but not claim damages. A negligent misrepresentation may give the person induced to enter a contract the right to sue the statement maker for damages.

Statements of fact that are untrue

PART 2

TABLE 8.6 Types of misrepresentation

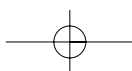
Type	Features
Fraudulent	False statement of fact Known to be false or recklessly indifferent Intention that other party should act/rely Reliance on statement Contract entered Damage suffered
Innocent	False statement of fact Not known to be false and no reckless indifference Intention that other party should act/rely No intention to deceive Contract entered Damage suffered
Negligent	False statement of fact/advice/opinion Made by person claiming special skill or expertise Contract entered Damage suffered

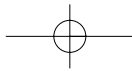
DISTINCTION BETWEEN SIMPLE REPRESENTATIONS AND REPRESENTATIONS THAT HAVE BECOME TERMS

Not all representations (statements of fact) have the same importance. A distinction is drawn by the law between **simple representations** as to facts and representations that have become **terms** of the contract. Simple representations as to facts are not terms of the contract. They are simply statements that induce the making of the contract. If, however, a party making a statement promises that the statement made is true to the extent that they make this part of the contract, then it is more than a simple representation. The statement becomes a term of the contract. If a term of a contract is not met, the other party is entitled to sue for breach of contract.

Simple representations are not terms of the contract

The remedies available will depend on the type of term. If it is a fundamental term—a **condition**—it will entitle the injured party to rescind the contract and claim damages. If it is a





less significant term—a **warranty**—there will be no right to rescind but there will be a right to claim damages. The distinction between conditions and warranties is discussed at some length in the next chapter.

The distinction between fraudulent and innocent misrepresentation is therefore only significant, in terms of remedies, where the statement made is a simple representation and not a contractual promise. If the representation has become a term, the remedies given are common-law remedies and they are given irrespective of whether the statement was made fraudulently or innocently.

We will now consider the different types of misrepresentation.

FRAUDULENT MISREPRESENTATION

A fraudulent misrepresentation occurs when a false statement of fact is made:

- knowingly, *or*
- without belief in its truth, *or*
- recklessly, *or*
- carelessly as to whether it is true or false.

Statement must induce person
to enter contract

The statement must induce a person to enter a contract. The following elements must be made out to prove a fraudulent misrepresentation:

1. The representation must be a statement of **fact** as opposed to a statement of opinion or a statement of law. It is possible in some cases for a statement of opinion to amount to a misrepresentation. This will be so where the person giving the opinion does not honestly hold that opinion or a reasonable person could not hold such an opinion. Another exception is where, although the statement was couched as an opinion, the statement maker implied that facts were known that justified the opinion.

Note that the position would be different if the statement maker were an expert or held themselves out as an expert. Such a statement may amount to a negligent misstatement.



CASE EXAMPLE

Smith v. Land & House Property Corp. (1885) 28 Ch D 7

Decision: The statement 'the whole property is let to Mr Frederick Fleck (a most desirable tenant)' was held to be a misrepresentation even though it was expressed as an opinion.

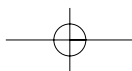
2. The statement must be untrue.
3. The statement must be known to be false, or be made without belief in its truth, or be made recklessly. If the statement made by a person was genuinely believed by that person to be true, then there could be no fraudulent misrepresentation, even if this belief has been formed negligently.
4. The statement must be intended to induce the other party to enter a contract. Where the person entering the contract is not aware of the representation, this element will not be satisfied.

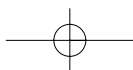


CASE EXAMPLE

Horsfall v. Thomas (1862) 1 H & C 90; 158 ER 813

Facts: The plaintiff had purchased a gun from the defendant. After he had fired it only six times, it exploded and he was injured. He sued the defendant, alleging that the weapon had been defective and that the defect had been fraudulently concealed from him.





Decision: The plaintiff was unsuccessful in his claim. He had not examined the weapon prior to purchase and, because of this, he could not say that he had been deceived by the alleged 'concealment'. He had not been misled and therefore could not sue for misrepresentation

The representation need not be the sole inducement to enter a contract but simply one of the factors that induced the party to enter the contract.

- The contract must be entered by the other party on the basis of the inducement. A party who knows that a statement is false cannot claim to have been induced by that statement to enter the contract.

Representation need not be sole inducement

CASE EXAMPLE

Holmes v. Jones (1907) 4 CLR 1692

Facts: The owners of a property falsely represented the number of stock on their property in order to obtain a purchaser. The purchasers had the property and stock inspected and discovered the true number of stock prior to entering the contract to purchase. The purchasers sought to rescind the contract alleging a misrepresentation regarding the number of stock on the property.

Decision: The contract could not be rescinded for misrepresentation, as the false statement had not been relied on by the purchasers in entering the contract. The purchasers, as a result of the inspection, knew that the statement was untrue. They could not therefore allege a misrepresentation.

- Damage must be suffered by the person entering the contract. Generally this will be of a financial nature.



LAW IN ACTION

Malcolm is a land agent. With an intention to induce Danielle to enter a contract, he tells her that the ceiling of the property he is selling is insulated. This is untrue as the ceiling is not insulated. If a contract is entered on the basis of that statement, then Danielle will suffer damage (financial) as insulation will have to be installed. The statement by Malcolm will amount to a misrepresentation and allow Danielle to avoid the contract.



SILENCE AND MISREPRESENTATION

Can silence constitute a misrepresentation? As a general rule, silence will not amount to a misrepresentation. However, there are a number of exceptions to this general rule. Where the statement made is a half-truth, the failure to make full disclosure may amount to a misrepresentation. If the statement maker subsequently discovers that the statement made was false, then the statement maker is under a duty to correct the statement, otherwise an action for misrepresentation will lie.

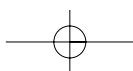
Silence does not usually amount to a misrepresentation

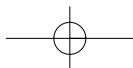
Another exception is where a previously made statement may become untrue as a result of changes in circumstances—that is, the statement was true when made but has become false as a result of changes in circumstances.

CASE EXAMPLE

With v. O'Flanagan [1936] 1 Ch 575

Facts: The plaintiffs contracted to purchase the medical practice of Dr O'Flanagan. O'Flanagan stated that the practice produced an income of approximately £2000 per year. At the time the statement was made, it was correct. However, in the four months between the statement being made and the signing of the contract, O'Flanagan became ill and did





Online subscribers sue over traffic jam

ERIC ELLIS, Los Angeles

The Internet took a battering this week in Los Angeles, where the world's biggest Internet service provider, American Online, copped a class action from five subscribers frustrated at getting busy signals when they tried to log on. The five are seeking damages for fraudulent and malicious misrepresentation by AOL, on behalf of its seven million customers.

The suit was filed in California Superior Court in Los Angeles on Monday and comes after recent remarks from Californian telephone provider Pacific Bell that Internet demand is clogging its capacity, with the average length of a call extending from four minutes for conversation to more than 20 minutes for Internet users.

Heightened competition from providers prompted AOL to switch from a metered charging system to offering an unlimited package.

Users can theoretically stay permanently logged on to AOL for just \$US19.95 a month. The previous charge was \$US9.95 a month for five hours. AOL said it was spending \$US250 million upgrading capacity and was confident of defending itself in the court action.

"Although we understand the frustration some members are experiencing in not being able to maintain immediate local access during peak periods, the average AOL member gets

more value under unlimited pricing than ever before," the company said.

The class action claims AOL's unlimited usage claim is meaningless if a user cannot log on.

Despite the boom in Internet services, 11-year-old AOL is struggling with its profits, due in part to its continual investment in new equipment and tight competition from similar Internet start-ups.

Nevertheless, it is planning to set up shop in Australia.

The week has delivered a bumpy ride for a number of Internet-focused companies.

One of the technology sector's most-plugged new issues, Netscape Communications, was routed on an otherwise booming Wall Street after a series of sceptical analysts' reports.

Netscape is the technoplist that dominates the market for browsers which power access to the Internet, from which Silicon Valley boffins are still trying to determine a surefire way to generate profits.

Its market battering was the second in a week and it is now trading around 25 per cent lower than at the end of 1996 after the brokers' savaging. Merrill Lynch suggested that Netscape had scrambled to make sales before the year-end in order to give its 1996 figures a gloss that could hurt its coming year.

"They closed a significant amount of business on December 31 just to make the quarter, which they've never had to do before," Merrill Lynch said. "We have heard of two major deals that were closed on December 31, one of which apparently closed late in the evening."

Netscape have denied the charge.

Last week, Deutsche Morgan Grenfell also offered a sceptical report on Netscape.

Another of the Internet's great sharemarket hopes, Yahoo Inc, found itself back in profits, posting a modest \$US96,000 earnings and a turnaround on the loss of \$1.15 million in the third 1996 quarter.

Revenues were \$US8.55 million compared with \$US1.075 million a year earlier and up 55 per cent from the third quarter of 1996. Wall Street had expected it to turn in a loss.

Yahoo represents one of the best examples of the sharemarket's romance with Internet-related issues. Its modest profits and sales of \$US19.1 million hardly merit a company for which aggressive Japanese media group Softbank paid \$US137 million for a 37 per cent stake last year.

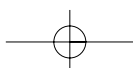
Source: The Australian Financial Review, 17 January 1997, p. 57, Computers Section.

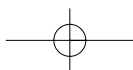
Newspaper discussion questions

1. Who is suing AOL?
2. What has AOL allegedly done wrong?
3. What remedy is being sought?
4. Explain AOL's response to the legal action.

not operate the practice. A number of locums took over and the practice became virtually worthless. When the plaintiffs discovered this, they sought to rescind the contract on the basis that it had been entered as a result of a misrepresentation.

Decision: The plaintiffs were entitled to rescind the contract and have the purchase money returned. When a representation is made to induce a contract, it is not sufficient that the statement is true only at the time it was made. If circumstances change prior to the contract being executed, the statement maker has to advise the other party to the contract of those changes.





If a statement is made between parties who are in a **fiduciary** relationship, silence may amount to a misrepresentation. A fiduciary is under a positive duty to make full disclosure of all material facts.

The last exception to the rule that silence cannot amount to a misrepresentation is contracts *uberrimae fidei*, which is Latin for 'of the fullest confidence.' These contracts require the utmost good faith. A good example is an insurance contract. See Chapter 11 for a more detailed discussion of such contracts.

Remedies for fraudulent misrepresentation

A person induced to enter a contract due to a fraudulent misrepresentation has the right to rescind the contract and claim damages. The contract is **voidable** at the option of the injured party.

Rescinding a contract brings it to an end. The parties to the contract are restored to the positions they were in prior to entering the contract. However, the right to rescind will be lost in certain situations. They are:

- if the party entitled to rescind takes some action to affirm the contract after becoming aware of the misrepresentation
- if a third party acting in good faith acquires the subject matter of the contract (e.g. purchases it) before the right to rescind is exercised
- if it is impossible to restore the parties to the positions they were in prior to entering the contract.

Lapse of time may also affect the right of a person to claim rescission of contract. This is so particularly if a large amount of time expires between the making of a representation and the attempt to rescind.

CASE EXAMPLE

Leaf v. International Galleries [1950] 2 KB 86

Facts: Leaf was induced to buy a painting titled *Salisbury Cathedral* that was claimed to have been painted by John Constable, but it was not until five years after the purchase that he discovered that the picture was not a Constable. Leaf then sought to rescind the contract.

Decision: It was not possible to rescind the contract. The court said that it was too unfair to exercise the right of rescission five years after the purchase. The court said that the plaintiff had ample opportunity to examine the painting straight after its purchase and determine its genuineness. Leaf received what he contracted for, which was a painting titled *Salisbury Cathedral*.

Leaf's case may be decided differently today, applying modern consumer laws.

INNOCENT MISREPRESENTATION

An innocent misrepresentation is one where the maker of the false statement believes it to be true, when in fact it is false.

Remedies for innocent misrepresentation

The common law provides an injured party with no remedy for an innocent misrepresentation. There is no right to rescind and/or claim damages. There are exceptions to this rule. Rescission is permitted if:

- the misrepresentation has become a term of the contract (see Chapter 9 for a more detailed discussion of this point)
- there has been a total failure of consideration
- the representation was made negligently. A liability in tort may be incurred in this situation.

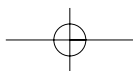
Duty to make full disclosure

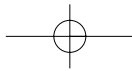
Rescission and damages

Impact of lapse of time



Maker of statement believes it is true





Legislation altering
the common law

It should be noted that legislation in South Australia (*Misrepresentations Act 1971*) and in the Australian Capital Territory (*Law Reform (Misrepresentation) Ordinance 1977*) has the effect of allowing damages to be claimed for both innocent and fraudulent misrepresentations.

MISREPRESENTATIONS AND THE TRADE PRACTICES ACT 1974 (CWLTH)

The *Trade Practices Act 1974* prohibits various types of misleading and deceptive statements by corporations engaged in trade and commerce. This topic is discussed in some depth in Chapter 13.

NEGLIGENT MISREPRESENTATION

Special skill or expertise

A person may be entitled to claim damages in tort for a misrepresentation if it has been made negligently. As discussed in Chapter 3, three elements must be proved to show negligence:

- a duty of care is owed
- that duty has been breached
- loss has been suffered.

It was acknowledged in 1964 in the English case of *Hedley Byrne & Co. Ltd v. Heller & Partners Ltd* [1964] AC 465 that an action in negligence could be mounted for negligent misstatement. This right arises if one party is giving advice to another party and professes to have some special skill or expertise. This person must be aware that the person to whom the advice is given believes that the person giving the advice has some expertise. In such a case, the person giving the advice is under a duty to take reasonable care. If there is a failure to exercise reasonable care and loss is suffered, the maker of the statement will be liable for this loss.

Only extends to
giving information

To whom does this duty to take reasonable care extend? It extends to persons giving advice in the course of a business or profession and to those who profess to have a degree of skill and expertise in a particular area, which would be comparable to a person carrying on a business or profession in that area. The duty extends to the giving of information, as illustrated by the following case.



CASE EXAMPLE

L. Shaddock & Associates Pty Ltd v. Parramatta City Council (No. 1) (1981) 150 CLR 225

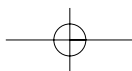
Facts: A solicitor, acting on behalf of Shaddock, contacted the Parramatta Council to ask them whether a property was affected by road-widening proposals. The council employees issued a form and made other statements that wrongly indicated that the property was not affected. Shaddock subsequently purchased the property and suffered losses when road-widening took place. Shaddock sued the council for negligent misstatement.

Decision: Shaddock was entitled to \$170 000 compensation for negligent misstatement. The court said that the council was giving information to a person whom they knew would rely upon it and they were under a duty to exercise reasonable care that the information was correct.

The High Court of Australia, in *San Sebastian Pty Ltd v. Minister Administering Environmental Planning and Assessment Act 1979* (1986) 162 CLR 340, suggested that a defendant **volunteering information** or advice could also be liable for negligent misstatements. This considerably extends those potentially liable.

Precontractual arrangements

Liability for negligent misrepresentation also extends to precontractual arrangements, as is illustrated by the following case. If a party prior to entering a contract makes a negligent misrepresentation, then the other party may be entitled to sue for damages. This will be the case if the party making the statement professes to have special skill, knowledge or expertise.



CASE EXAMPLE

Esso Petroleum Co. Ltd v. Mardon [1976] QB 801

Facts: Mardon leased a service station from the Esso Petroleum Co. Ltd. The lease was arranged in reliance on negligent statements regarding potential petrol sales that were made by an experienced servant of the oil company. The statements were untrue and, as a result of them, Mardon suffered loss.

Decision: Mardon could recover damages from the oil company for negligent misrepresentation.

Table 8.7 below summarises the remedies available for the types of misrepresentation we have considered.

Type of misrepresentation	Remedies
Fraudulent	Contract may be rescinded Damages recoverable
Innocent	Contract may be rescinded Damages recoverable for breach of contractual term
Negligent	Contract may be rescinded Damages recoverable in tortious action

Duress

Duress is another ground for alleging that reality of consent is missing from an agreement. Duress will occur when a person enters a contract because of actual or threatened violence to this person or to a person with whom they have a close relationship (e.g. threats to a spouse, child or parent). Conduct amounting to duress does not have to come from the other party to the agreement. It may come from a person acting on behalf of a party to a contract.

The law does not require violence to have occurred. Threats of violence are sufficient. A threat to imprison a person in order to get this person to enter a contract would amount to duress. Table 8.8 (see p. 66) provides an overview of the major types of duress.

The onus of proving duress rests with the person alleging it. The effect on a contract is that it will be **voidable** at the option of the injured party. Rescission of the contract is permitted because the element of reality of consent is absent. The consent of one party has been given because of duress.

The duress does not need to be the only reason a party enters a contract; it will be sufficient if it is *one* of the reasons.

CASE EXAMPLE

Barton v. Armstrong [1976] AC 104

Facts: The plaintiff argued he had signed a deed for the purchase of the defendant's shares in a company because of duress by the defendant. The court, at first instance, decided threats had been made by the defendant against the plaintiff's life, but the plaintiff was motivated to sign the deed for business reasons and so the court dismissed his action. The plaintiff appealed.

The New South Wales Court of Appeal dismissed the appeal on the basis that the plaintiff had not established that he would not have executed the deed but for the defendant's threats. There was a further appeal to the Privy Council.

Decision: The court decided that the execution of the deed by the plaintiff had been made under duress. The court stated that the threats and unlawful pressure imposed by the defendant contributed to the plaintiff's decision to sign the documents.



Actual or threatened violence

Onus of proving duress



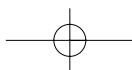


TABLE 8.8 Examples of duress

Type of duress	Characteristic
Duress against a person	Actual or threatened violence
Duress against property	Threats against property or goods
Economic duress	Financial pressure to gain an advantage not in the terms of the contract

DURESS AGAINST GOODS

No common-law remedy

At common law, there is no remedy for the situation where the duress is addressed to goods and not to the person. The rationale is that a person may find it hard to resist violence or threats to themselves because of fear, but resistance should be possible if the violence or threats are against goods. Goods can be replaced, and any damage to them could be compensated by the payment of money.

ECONOMIC DURESS

Threats that cause monetary loss

The law recognises economic duress. It recognises that purely economic threats made to induce a party to enter a contract may amount to duress. An economic threat is one that, if carried out, would cause monetary loss to the party entering the contract. Situations in which economic duress have arisen are where the parties are in a contractual relationship and one party seeks the other party to enter into another, less profitable, contract.



CASE EXAMPLE

North Ocean Shipping Co. Ltd v. Hyundai Construction Co. Ltd [1979] QB 705

Facts: Hyundai (the defendant company) agreed to build a tanker for the plaintiff company. The price was fixed in US dollars. There was a devaluation of the US dollar and the defendant demanded that the price be increased. The plaintiff agreed unwillingly and Hyundai provided consideration by varying the original contract.

Decision: The court held that economic pressure (duress) had been exerted by Hyundai and this would give the plaintiff a right to rescind the contract. The court found, however, that the plaintiff had lost the right to rescind by affirming the contract.



CASE EXAMPLE

Cockerill v. Westpac Banking Corporation (1996) 142 ALR 227

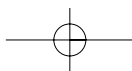
Facts: In the course of negotiations relating to Cockerill's finances, Westpac was granted a release from potential legal claims arising from offshore loans established by Westpac for Cockerill. The release followed a threat by Westpac to appoint a receiver and manager to sell assets, which had been mortgaged by Cockerill.

Decision: The High Court of Australia found that the threat to appoint receivers and managers by Westpac amounted to economic duress during negotiations. This threat had resulted in Westpac obtaining the release. In order to avoid the appointment of a receiver and manager, Cockerill had no choice but to accept the course of action proposed by Westpac.

Undue influence

Presumption of undue influence

An allegation of undue influence is another ground for alleging that reality of consent is absent from a contract. Undue influence occurs when a person uses their influence over another to force the other to enter a contract. The law has identified several relationships where it will presume that undue influence exists. These involve one person being in a position of authority or power over another person. The relationships include those set out in Figure 8.6.



- Parent and child
- Guardian and ward
- Solicitor and client
- Doctor and patient
- Trustee and beneficiary
- Religious adviser and devotee

FIGURE 8.6 Relationships where undue influence will be presumed to exist

The above list is not exhaustive of relationships where a presumption of undue influence will arise. It is possible that the courts will add to this list in the future. Note that there is no presumption of undue influence in the husband and wife relationship.

If a special relationship (i.e. one mentioned above) exists, the onus of proving that the agreement was made voluntarily will rest with the person in the dominant position. For example, a doctor, solicitor or parent accused of undue influence has the onus of showing that there was no undue influence. This party must show that the consent of the person in the weaker position (e.g. the patient, client or child) was given freely.

If a special relationship does not exist, an allegation of undue influence can still be made by a party to a contract. The law will not presume undue influence has been exercised. The onus of proving undue influence will rest on the person alleging it. This will be the person who is in the weaker position.

An explanation of undue influence is provided by Hodges J in *Union Bank of Australia v. Whitelaw* [1906] VLR 711 at 720:

‘Undue influence’ is the improper use by the ascendant person of such ascendancy for the benefit of himself or someone else, so that the acts of the person influenced are not, in the fullest sense of the word, his free, voluntary acts.

To prevent an allegation of undue influence being made or succeeding, it is advisable for a person who could be regarded as being in a dominant position recommending that the other party to the agreement seek independent legal advice before entering the contract.

A contract entered as a result of undue influence is voidable at the option of the weaker party. The right to rescind a contract because of undue influence must be exercised swiftly; otherwise the right may be lost.

Onus of proving agreement was voluntary

PART 2

Contract voidable

CASE EXAMPLE

Allcard v. Skinner (1887) 36 Ch D 145

Facts: Allcard (the plaintiff) joined a religious order in 1868. The mother superior of that order was Skinner (the defendant). Allcard took a vow of poverty and, in accordance with that vow, she gave money and railway stock to Skinner to be held in trust for the general purposes of the order. Allcard left the order in 1879 and six years later claimed the return of her property, alleging undue influence.

Decision: The court found that, at the time of making the gift, the plaintiff was under the undue influence of the defendant and would be entitled, on leaving the order, to recover the property from the defendant. The problem was that she had not commenced action until six years after leaving the order. The plaintiff lost the right to rescind. The court said that by delaying, she had acquiesced in the continuation of the gift.

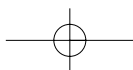


CASE EXAMPLE

Farmers' Co-operative Executive and Trustee Ltd v. Perks (1989) 52 SASR 399

Decision: The Supreme Court of South Australia found that a married woman who entered into a contract was doing so under the undue influence of her violent husband. There was evidence that the violence had been taking place for many years. This was sufficient to satisfy the court that undue influence was exerted.





Unconscionable contracts at common law

Stronger party takes advantage
of weaker party

At common law, it is possible to argue that reality of consent is missing from an agreement by alleging unconscionable conduct. The term unconscionable means 'excessively unreasonable'. An agreement will be regarded as **unconscionable** where one party to a contract, being in a position of power with respect to another party, forces this weaker party into the contract. The resulting contract is one that is unreasonable, being very favourable to the stronger party.

It might appear that the notion of unconscionableness is the same as undue influence, but it is not. The distinction between these concepts is explained in the following case.



CASE EXAMPLE

Commercial Bank of Australia Ltd v. Amadio (1983) 151 CLR 447

Facts: Mr and Mrs Amadio gave a mortgage to the bank over an office block owned by their son. This was to secure a loan from the bank taken out by a company in which their son was involved. The parents guaranteed to pay the bank if the son's company defaulted on the loan. At the time the contract was made, neither parent had a good grasp of the English language, both were elderly, and they received no independent legal advice. The parents believed that the extent of their liability was far more limited than it was. The difference between unconscionable conduct and undue influence is explained well by Deane J at 474:

The equitable principles relating to relief against unconscionable dealing and the principles relating to undue influence are closely related. The two doctrines are, however, distinct. Undue influence, like common law duress, looks to the quality of the consent or assent of the weaker party ... Unconscionable dealing looks to the conduct of the stronger party in attempting to enforce, or retain the benefit of, a dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so.

Decision: The court said that there was unconscionable conduct on the part of the bank. The bank should have given assistance, and there was no reasonable degree of equality between the bank and Mr and Mrs Amadio. The contract was held voidable at the option of the plaintiffs.



CASE EXAMPLE

Louth v. Diprose (1992) 110 ALR 1

Facts: Louth financed the purchase of a house by Diprose. Louth had deep feelings of affection for Diprose. Diprose did not share his feelings but exploited them to her benefit. Diprose threatened suicide at the prospect of not obtaining finance to purchase the house in question.

Decision: The High Court of Australia found that Diprose's conduct was unconscionable and ordered the house to be transferred from Diprose to Louth.

The types of disability that may give rise to unconscionable conduct are illustrated in Figure 8.7.

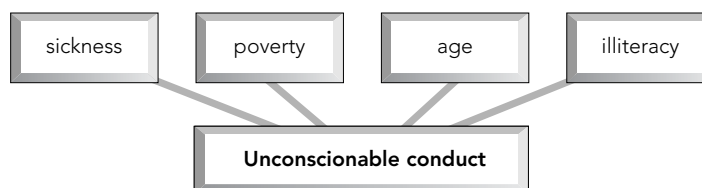
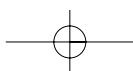


FIGURE 8.7 Disabilities that may give rise to unconscionable conduct



STATUTES PROHIBITING UNCONSCIONABLE CONDUCT

A number of statutes prohibit unconscionable conduct. We will briefly examine these.

The Trade Practices Act 1974 (Cwlth)

Section 51AB provides:

(1) A corporation shall not, in trade or commerce, in connection with the supply of or possible supply of goods or services to a person, engage in conduct that is, in all the circumstances, unconscionable.

A breach of s. 51AB gives the injured party a number of remedies. They include:

- damages
- an injunction
- a right to avoid the contract
- orders for the payment of money, the making of repairs, or the provision of services.

Section 51AB does not define the term 'unconscionable'. However, s. 51AB(2) lists a number of factors that will be relevant to a determination. These matters include:

- the relative strengths of the bargaining positions of both parties
- whether any undue influence was exerted
- whether the consumer was able to understand documentation with respect to the transaction.

Sections 51AC and 51AD also protect small businesses against unconscionable conduct.

Contracts Review Act 1980 (NSW)

This Act gives the Supreme Court of New South Wales power to review unjust contracts. These contracts involve 'unconscionable, harsh or oppressive' conduct. The court, when determining if a contract is unjust, must consider the public interest and several factors listed in s. 9(2). The list in s. 9(2) is not intended to be exhaustive, as was pointed out in *Sharman v. Kunert* [1985] 1 NSWLR 225. It includes factors such as:

- whether there is inequality of bargaining power between the parties
- precontractual obligations of the parties
- whether the contract can be renegotiated
- whether the age, physical or mental health of the person claiming relief was such that this would prevent the person from protecting their interests
- whether any undue influence or unfair pressure was brought to bear on a party to a contract.

If a contract is regarded as unjust, the court can refuse to enforce all or any of its terms. It can make an order declaring the contract void, or it can order a variation of terms. The court also has the power to grant injunctions. The scope of the Act is limited in a number of ways. The Act does not apply to corporations unless registered under the *Strata Titles Act 1973* (NSW).

CASE EXAMPLE

Atonovic v. Volker [1986] 7 NSWLR 151

Decision: A contract made after a successful bid at an auction for the sale of land was declared void as it was regarded as unjust. The court found that unfair pressure had been applied by a real estate agent to the purchaser. The purchaser would not have made a bid except for the pressure that had been applied.

LEGALITY OF OBJECT

The sixth (final) element necessary to create a valid contract is legality of object. The factors relevant to the question of legality are set out in Figure 8.8. The object or purpose of a contract must be legal. Contracts may be illegal either at common law or pursuant to a statute.

Factors relevant to establishing unconscionable conduct

Public interest consideration

Power of court



Contract may be illegal at common law or pursuant to a statute

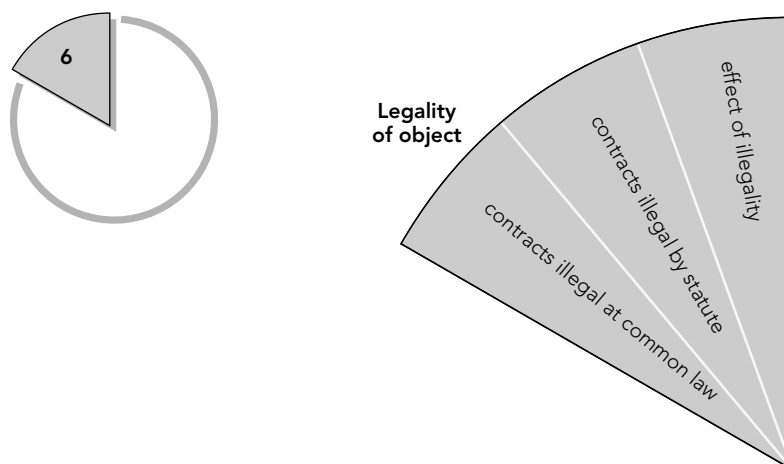
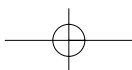


Figure 8.8 Factors relevant to the element of legality of object

Contracts illegal at common law

There are a number of contracts that are illegal at common law. These contracts are either against public policy or involve the commission of an illegal act. The major categories are described below.

CONTRACTS DESIGNED TO DEFRAUD THE GOVERNMENT OF REVENUE

Contracts intending to defraud State or federal authorities of revenue are illegal (e.g. contracts intending to defraud in respect of liability for land, sales or income tax).



CASE EXAMPLE

Alexander v. Rayson [1936] 1 KB 169

Facts: Alexander let a flat to Rayson for a rental of £1200 per year. With the object of getting a low value for rating purposes, two written agreements were entered. One purported to rent the flat for £450 a year and the other was an agreement by Rayson to pay the plaintiff £750 a year for services in connection with the flat. Alexander sued Rayson for an instalment of £750.

Decision: The court held that the agreement was made to defraud the rating authority and was therefore void, so Alexander failed in his action.

CONTRACTS TO COMMIT AN UNLAWFUL ACT

A contract to commit a crime or a tort (i.e. any unlawful act) is illegal.

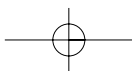
Agreements to commit
a crime or tort



CASE EXAMPLE

Beresford v. Royal Insurance Co. Ltd [1938] AC 586

Facts: A Major Rowlandson insured his life for the sum of £50 000. He fell into financial difficulties and owed creditors £60 000. A couple of months before the policy was due to expire, he shot and killed himself to enable creditors to receive the benefit of the policy, which was his only asset.



Decision: Because suicide was a criminal offence, it was held that his executors could not recover on the policy. The court would not enforce the contract as it was illegal and contrary to public policy.

CONTRACTS THAT HINDER THE ADMINISTRATION OF JUSTICE

A contract made between parties, where one person agrees not to reveal information that could assist in the investigation of a crime, is illegal.

CASE EXAMPLE

Public Service Employees Credit Union Co-operative Limited v. Campion (1984) 75 FLR 131

Facts: Campion guaranteed repayment of a loan, advanced by the plaintiff credit union to his son, on the understanding that the credit union would not report his son to the police for misappropriation of funds from the credit union.

Decision: The guarantee was an illegal contract as it amounted to an agreement to stifle the prosecution of an indictable offence.

CONTRACTS THAT ARE PREJUDICIAL TO THE INSTITUTION OF MARRIAGE

An agreement where the parties to a marriage agreed, before they were married, not to live together when married, would be against public policy. Marriage brokerage contracts—where one party undertakes to find a marriage partner for another in exchange for a fee—are also illegal.

Public policy consideration

CONTRACTS THAT ARE SEXUALLY IMMORAL

A contract between a prostitute and a client would be illegal. Note that by statute in certain States and Territories, prostitution has been legalised in certain licensed premises.

CONTRACTS THAT PROMOTE CORRUPTION IN PUBLIC LIFE

Contracts that involve the corruption of a public official (e.g. bribery) are illegal.

CASE EXAMPLE

Wilkinson v. Osborne (1915) 21 CLR 89

Facts: An agreement was made between the agent of the owner of a property and two members of the New South Wales Parliament. The owner required a report on his land from an advisory board to ascertain whether the land was suitable for purchase by the Government.

It was necessary for both houses of parliament to approve such a purchase. The agent agreed to pay the members if they would take the matter up with the Government quickly.

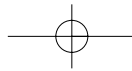
Decision: The court held that the agreement was illegal.

CONTRACTS THAT INVOLVE A CONFLICT OF PRIVATE INTEREST WITH DUTY

An employee or agent who allows their interest, financial or otherwise, to interfere with their duty may be guilty of a breach of duty to their employer or principal.

CONTRACTS IN UNREASONABLE RESTRAINT OF TRADE

A contract in restraint of trade is one that restrains or hinders a person's ability to undertake their trade or profession. Such contracts are unenforceable unless they are reasonable. In



Duration and extent of constraint considered

addition, these contracts must also be supported by some consideration. A contract must be reasonable in the interests of the public and between the parties to the contract. The restriction can be no wider than is reasonable to protect the person for whose benefit the contract is made.

In determining whether a restraint is reasonable, courts must consider the duration and the extent of the restraint. They also consider whether the restraint is in the interests of the parties to the agreement, and whether it is in the public interest. The **duration** of the restraint is how long it will be operative. The **extent** of the restraint refers to the geographical extent of the restraint.

There are two broad categories of contracts (see Figure 8.9) in restraint of trade: those involving the sale of a business, and those made between an employer and employee, restraining the employee from engaging in a competing business while in employment or after termination of employment.

Contracts for sale and purchase of a business

These contracts will often include a clause restraining the seller from setting up a competing business nearby.

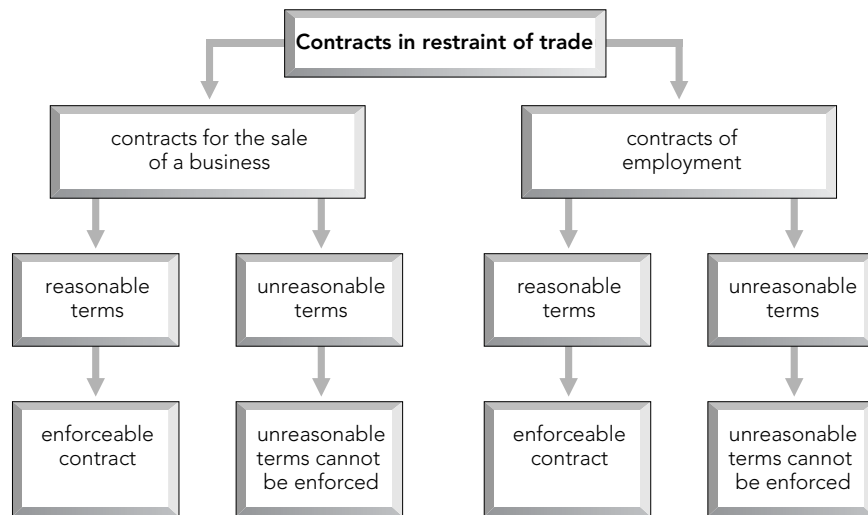


Figure 8.9 Contracts in restraint of trade



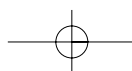
LAW IN ACTION

Anna and Peter operate a service station. They decide to sell the business and so enter a contract of sale with Rodney and James. The sellers agree that they will not operate a service station within three kilometres of the old station for three years. This clause is one in restraint of trade, since it restricts Anna and Peter from trading freely. However, this clause would be regarded as reasonable, since it protects the goodwill that the purchasers have paid for.

Considerations for the court

When confronted with a clause in restraint of trade, the court will ask if it is reasonable between this particular seller and buyer. The court will also ask if the restraint is in the public interest. In determining whether the clause is reasonable, the court will consider the duration of the restraint (three years in the above example) and the extent of the restraint (3 km). It will ask whether the restrictions are reasonable in protecting the goodwill that has been purchased.

It is difficult to lay down rules for determining if the duration and extent of a restriction are reasonable. The court will need to consider the facts in each case.



CASE EXAMPLE

Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co. Ltd [1894] AC 535

Facts: Clauses were included in a contract for a sale of a munitions business that had worldwide customers. Nordenfelt agreed to refrain from establishing a similar business in Europe and North America within the next twenty-five years.

Nordenfelt breached the agreement by opening a competing business. The company sought to enforce their agreement. Nordenfelt argued the agreement was too restrictive.

Decision: The court held that this was a reasonable restraint, given the nature of the business.



CASE EXAMPLE

Coombs v. Bahama Palm Trading Pty Ltd [1991] ASC 56-097

Facts: A contract for the sale of a restaurant contained a clause that prohibited the vendor carrying on a business of the same nature as the business sold within a designated time and area. The restaurant in question was a sit-down restaurant. Following the sale, the vendor established a fast food business within the designated area and time frame. The purchaser argued that this breached the contract for the sale of the business.

Decision: The establishment of the fast food business breached the contract. The supply of food and coffee was the main purpose of each business and the manner in which it was consumed was only incidental to the purpose of each business. The purchaser of the restaurant was entitled to enjoy the benefits of the business without the vendor opening a similar business within the designated area and time frame.



CASE EXAMPLE

Lloyd's Ships Holdings Pty Ltd v. Davros Pty Ltd (1987) 17 FCR 505

Facts: A contract for the sale of a shipbuilding business, which specialised in the construction of luxury motor vessels, contained a restraint of trade clause. The clause prevented the sellers from engaging in 'the business of shipbuilding of any description or any other business of a similar nature'. The court had to decide if the clause was reasonable.

Decision: The court decided that the clause was not reasonable. The clause amounted to an unreasonable restraint of trade. It was not reasonably necessary to protect the interests of the purchaser.



Unreasonable contracts of employment

It is common for contracts of employment to include a clause restraining an employee from carrying on their trade or profession in competition with their employer while in employment or after termination of their contract of employment. Courts are reluctant to enforce such restrictions. However, a person can be prevented from disclosing an employer's trade secrets.

Large companies that have valuable intellectual property upon which their goodwill and reputation are based are much more likely to have such a contract enforced—for example, companies such as Microsoft and Coca-Cola Amatil.

The test of reasonableness will be applied, as in contracts for the sale of a business. However, courts are reluctant to enforce agreements in restraint of trade between employer and employee. They will construe them less favourably than those made in connection with the sale and purchase of a business, because of the unequal bargaining position of the parties. The employer will always be in the more dominant position.

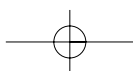
Courts reluctant to enforce

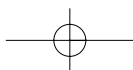
Trade secrets cannot be disclosed

CASE EXAMPLE

Schroeder Music Publishing Co. Ltd v. Macaulay [1974] 1 WLR 1308

Facts: Macaulay published music, and he entered into an agreement whereby he agreed to provide his exclusive services to the plaintiff company for five years (with a right to





extend for ten years). He assigned (transferred) copyright in all compositions to be written by him during the five year period to the plaintiff. The defendant would receive half the royalties.

Decision: The court held that the agreement was void. The period of five years was too long. The defendant's bargaining position was weak and the court decided that he had been taken advantage of.

Trade secrets cannot
be disclosed

It is not possible for an employer to restrain an employee from using skills and expertise they have acquired because of their employment. However, there are some restraints that the court will uphold. An employee can be restrained from:

- using a confidential list of their employer's customers to solicit business for themselves
- disclosing a secret process
- working for a competitor during their current employment or assisting that competitor.



CASE EXAMPLE

Littlewoods Organisation Ltd v. Harris [1978] 1 All ER 1026

Facts: An employee gained confidential information while preparing and planning mail-order catalogues for his employer. A clause in his contract of employment restrained him from working for a rival mail-order business for twelve months after leaving his employment.

Decision: The court held that this restraint was reasonable.

Restraint imposed on
skills and expertise

It is not possible simply to prevent a former employee from competing with an employer after leaving that employment. This rule is illustrated by the following case examples.



CASE EXAMPLE

Attwood v. Lamont [1920] 3 KB 571

Facts: Attwood was a tailor and draper who carried on business in Melbourne. Attwood entered a contract of employment with Lamont. The contract contained a clause providing that in the event the contract terminated, Lamont would not carry on the business of a tailor at any place within a fifteen kilometre radius of Melbourne. Lamont left this position and established his own tailoring business in Geelong, outside the fifteen kilometre restriction. However, he filled orders from Melbourne. Attwood sued Lamont, alleging breach of contract. The issue for the court was whether the restrictions placed on Lamont were reasonable as they were in restraint of trade.

Decision: The court held that the clause in the contract was invalid as it was only directed at the prevention of competition. It was open to Lamont to compete with Attwood. The restraint was not regarded as reasonable. Lamont was free to establish his own business.

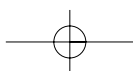


CASE EXAMPLE

Drake Personnel Ltd v. Beddison [1979] VR 13

Facts: The plaintiff company was an employment agency. The defendant was employed by the plaintiff company and entered a contract that provided that for twelve months after the termination of his employment, he would not carry on a business of the same kind as that of the plaintiff company within forty kilometres of the plaintiff's premises. The defendant left his employment and within a month set up a competing business within one kilometre of the plaintiff's business. The plaintiff sought an injunction preventing the defendant from breaching his contract. The court had to decide if the contract restraining the defendant was valid.

Decision: An injunction was not granted. The agreement was void because it was unreasonable—the forty kilometre restriction was excessive. The defendant was free to operate his competing business.



RESTRICTIVE TRADING AGREEMENTS

It is common for agreements that are made between manufacturers, retailers and wholesalers of goods and services to contain restrictive clauses (e.g. placing a restriction on the price at which goods may be resold). The *Trade Practices Act 1974* regulates such conduct. In Chapter 15 there is an extensive discussion of these practices.

Agreements between manufacturers, wholesalers and retailers

Contracts illegal by statute

Often a statute will prohibit certain conduct. The prohibition may be on the making of certain contracts. The effect of a prohibition on the validity of contracts needs to be considered. Some contracts will be rendered void (i.e. have no legal effect) while others will be rendered illegal and unenforceable. In the latter case, there is still a contract but it is unenforceable, while in the former case there is no contract.

An example of a contract prohibited by statute is an agreement to share the proceeds of a robbery. Some contracts will only be void against certain persons. For example, contracts to alter the incidence of income tax are void against the Commissioner of Taxation. Another example is certain dealings by an insolvent person. These dealings will be void against the insolvent person's trustee in bankruptcy. Table 8.9 outlines the State and Territory legislation that expressly prohibits certain betting and wagering contracts.

Examples

TABLE 8.9 Legislation prohibiting betting and wagering contracts

State/territory	Relevant legislation
New South Wales	<i>Gaming and Betting Act 1912</i>
Victoria	<i>Lotteries, Gaming and Betting Act 1966</i>
Queensland	<i>Racing and Betting Act 1980</i>
South Australia	<i>Lottery and Gaming Act 1936</i>
Western Australia	<i>Gaming and Betting Act 1985</i>
Tasmania	<i>Racing and Gaming Act 1952</i>
Australian Capital Territory	<i>Games, Wagers and Betting-Houses Act 1901</i>
Northern Territory	<i>Racing and Betting Act 1983</i>

If a statute regulates only the way in which the contract is performed, it will generally not be regarded as void. The contract will be enforceable by an innocent party. It is valid, and there will be a fine or sanction for non-compliance.

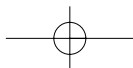
CASE EXAMPLE

Anderson v. Daniel [1924] 1 KB 138

Facts: A statute required a seller of fertiliser to give to purchasers invoices in a prescribed form. Failure to do so resulted in the seller being fined.

Decision: The court held that it was not the intention of parliament to make the formation of the contract illegal. The contract could be enforced by the innocent party.





Check your progress 8.3



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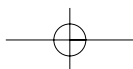
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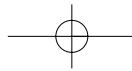
1. A false statement made knowingly that induces a person to enter a contract is:
 - (a) a fraudulent misrepresentation
 - (b) a negligent misrepresentation
 - (c) an innocent misrepresentation
2. Silence may amount to misrepresentation if:
 - (a) the parties are in a fiduciary relationship
 - (b) the parties are minors
 - (c) the parties are insane or intoxicated
3. If an innocent misrepresentation occurs, the general rule is that the common law provides:
 - (a) the remedy of rescission to the injured party
 - (b) no remedy to the injured party
 - (c) the remedy of damages to the injured party
4. A threat of violence to a contracting party would allow that party to allege that reality of consent is missing from an agreement because of:
 - (a) undue influence
 - (b) misrepresentation
 - (c) duress
5. The law presumes that undue influence exists between:
 - (a) adults of different ages
 - (b) doctor and patient
 - (c) siblings
6. A contract that is sexually immoral is an example of a contract that is illegal pursuant to statute.
 - (a) true
 - (b) false
7. A contract may restrain an employee from:
 - (a) disclosing secret processes
 - (b) using confidential lists of customers
 - (c) working for a competitor
 - (d) all of the above
8. Where a statute regulates only the way a contract is performed, the contract will generally be regarded as:
 - (a) enforceable
 - (b) void
 - (c) invalid

EFFECT OF ILLEGALITY

Is the contract capable of
 being severed?

It may be possible to enforce part of a contract. The illegal part of a contract may be severed and the legal part enforced. This can only happen if the contract is capable of being severed. This is often referred to as the **blue pencil test**: the illegal portions are deleted with a blue pencil and, if a valid contract remains, then it has passed the test.





CASE EXAMPLE

Gaskell v. King (1809) 11 East 165; 103 ER 967

Facts: The plaintiff leased premises to the defendant. The lease stated that the defendant would pay a property tax. However, pursuant to the provisions of a statute, this tax was required to be paid by the landlord. It was illegal for the landlord to demand the tax from a tenant. The defendant was sued for non-payment of rent. He raised a defence that the lease was void because of the clause regarding payment of the property tax.

Decision: The court decided the agreement to pay tax was distinct and separate from the contract for rental. This contract could be severed from the rest of the contract. The part of the lease imposing the tax was void but the remainder of the contract was legal. The landlord was entitled to receive the rent that was owing.

If an illegal portion of a contract cannot be severed from the legal part, the whole contract will be void.

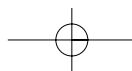
CASE EXAMPLE

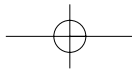
Napier v. National Business Agency Ltd [1951] 2 All ER 264

Facts: The plaintiff was employed as a secretary and accountant at a salary of £13 each week, plus £6 each week for expenses. Actual expenses were far less than £6 each week.

Decision: The court held that the contract was designed to evade tax and was therefore illegal. The court was unable to sever the part of the contract dealing with expenses, and so the whole contract was unenforceable.

It is common for money to be paid pursuant to an illegal contract. Generally, money paid under such circumstances is not recoverable.





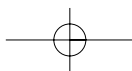
Chapter overview

The main points made in this chapter are:

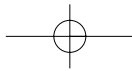
1. To create a valid contract, the elements of capacity of parties, reality of consent and legality of object must be present (along with the three other elements discussed in Chapter 7).
2. A minor has restricted capacity to contract. The following contracts will bind a minor:
 - contracts for necessities
 - contracts that benefit the minor
 - cash transactions.

A contract made with a minor that does not fall within the above groups may be voidable. Contracts that are voidable are: first, those contracts that are binding unless repudiated by the minor during minority or on attaining eighteen years of age; and second, those contracts not binding on a minor unless the minor ratifies on attaining majority.

3. Some contracts when made with minors will be void. A minor will not be liable on a cheque and, in some jurisdictions, will not be liable to repay money lent on security.
4. South Australia and New South Wales have statutes that modify the common-law rules dealing with the contractual capacity of minors.
5. Persons who are of unsound mind or are intoxicated have limited contractual capacity. Contracts made by such persons can be avoided if, at the time the contract was made, the impaired person did not understand what they were doing and the person with whom the impaired person was contracting knew of the disability. These persons will be bound by contracts for necessities.
6. Bankruptcy does not prevent a person from contracting but it does impose limitations. A bankrupt in certain cases must disclose that they are bankrupt before contracting.
7. A corporation has the same capacity to contract as an individual. This is subject to the requirement that the person acting for the corporation has the authority to do so.
8. Married women have the same contractual capacity as men. Previously, married women were unable to make contracts as they were regarded as the 'property' of their husbands.
9. Parties entering a contract must give consent freely. A contract can be avoided if entered because of duress, undue influence, mistake or misrepresentation.
10. Mistake can take two forms: mistake of law or mistake of fact. The former will not enable a person to avoid a contract, while the latter may.
11. A 'common mistake' is where both contracting parties make the same mistake. Mistake about the existence of subject matter or about a fact going to the root of the contract will render a contract void.
12. A 'mutual mistake' is where both contracting parties are mistaken but they make different mistakes. A contract entered because of a mutual mistake may be rendered void if it can be shown there was no offer and acceptance.
13. A 'unilateral mistake' is where one party to the contract is mistaken and the other party knows or ought to know of this mistaken belief. The contract may be able to be avoided (e.g. if the mistake is regarding a term of the contract, or the identity of a contracting party).
14. The effect of some mistakes on a contract is that the contract is void (i.e. of no legal effect).
15. A person who signs a document that is radically and fundamentally different from what that person believed they were signing may rely on the defence of non est factum ('it is not his deed'). The party must show that they exercised reasonable care when signing the document.



16. A 'misrepresentation' is a statement of fact that is untrue. It is made with the intention of inducing a person to enter a contract. If the contract is entered in reliance on the inducement, and damage is suffered, then the contract is voidable at the option of the injured party.
17. A fraudulent misrepresentation is made when the person making the statement knows it is false or is indifferent as to its truth or falsity.
18. An innocent misrepresentation is made when a person makes a false statement of fact believing it to be true.
19. Silence can amount to misrepresentation if it is a factor that induces a party to enter a contract.
20. At common law, the remedy for fraudulent misrepresentation is damages and rescission of contract. For innocent misrepresentation, there is only a limited right to rescission.
21. A right to rescind a contract for misrepresentation can be lost in certain circumstances.
22. A person giving information and professing to be skilled in a particular area can be held liable for a negligent misrepresentation if the information given is incorrect. For liability to arise, a duty of care must be established. Liability arises in the law of torts as opposed to contract law.
23. 'Duress' is actual or threatened violence to a contracting party, or to a person close to the contracting party, which induces this party to enter a contract. Such a contract is voidable at the option of the injured party.
24. Undue influence occurs when a person uses their influence over another person to coerce this other person into entering a contract. A contract so made is voidable at the option of the weaker party. The law presumes that in some 'special' relationships, undue influence may occur (e.g. doctor-patient and parent-child).
25. If a special relationship exists between contracting parties, the dominant party must prove that the agreement was entered freely. If no special relationship exists, the onus is on the party alleging undue influence to prove it.
26. A method of avoiding a contract is by arguing that there has been unconscionable conduct. This will occur when the respective bargaining power of one party far outweighs the power of the other party. A resulting contract is made by exercising influence over the weaker party. Factors that can be the basis of unconscionable conduct include age, poverty, illiteracy and ill health.
27. A number of statutes specifically prohibit unconscionable conduct to induce a person to enter a contract. They include the Trade Practices Act 1974 (Cwlth) and the Contracts Review Act 1980 (NSW).
28. The object or purpose of a contract must be legal. Contracts may be illegal at common law or by statute.
29. Contracts illegal at common law include contracts: to defraud the government of revenue; to commit an unlawful act; that hinder the administration of justice; that prejudice the status of marriage; that are sexually immoral; that promote corruption in public life; that involve a conflict of private interest with duty.
30. Contracts in restraint of trade will be unenforceable unless they are reasonable. These contracts must be reasonable as between the parties and in the public's interest. There are two categories of these contracts; contracts for the sale and purchase of a business, and employer-employee contracts. In determining if these contracts are reasonable, the duration and extent of the restraint will be examined.
31. Some statutes will make certain conduct illegal. The effect may be that a resulting contract is void or simply unenforceable. If a statute simply regulates the way a contract is to be performed, then a breach will not render the contract void.
32. If a contract is illegal, either at common law or by statute, it may be possible to divide it into two parts: an illegal part and a legal part. It may be possible to sever the illegal part and enforce the remainder of the contract. If severance is not possible, the whole contract will be unenforceable.

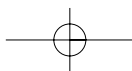


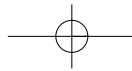
Consolidation questions

1. Define a 'voidable contract'.
2. When will a person of unsound mind be bound by a contract?
3. What types of contract will bind a minor?
4. Explain what impact bankruptcy has on a party's capacity to contract.
5. Under what circumstances may a party who signs a document rely on the defence of *non est factum*?
6. Distinguish between simple representations and representations that have become terms of a contract.
7. What is the difference between duress and undue influence?
8. Explain how a fraudulent misrepresentation and an innocent misrepresentation differ.
9. Under what circumstances can the right to rescind a contract for misrepresentation be lost?
10. Provide an example of a 'contract in restraint of trade' and explain the legal status of such a contract.
11. Provide three examples of contracts that are illegal at common law.
12. Give an example of a contract that is illegal by statute. What are the consequences of this?
13. What is meant by the term 'unconscionable'?

Case study questions

1. Eric, aged fifteen, is a talented guitarist who performs regularly in his home city. Don, his manager and tutor, arranges a tour around Australia designed to showcase Eric's unique talent. It is arranged that Eric will tour for six months and play twice a day, six days a week. Following extensive bookings and the hiring of several support staff, Eric gets cold feet and attempts to terminate the contract. Is Eric entitled to rescind the contract?
2. Bill owns a large yacht, which he moors at Kangaroo Island. Upon turning eighty years of age, he reluctantly decides to sell his beloved possession. After an extensive period of advertising Bill finds a willing purchaser in his home town, Adelaide. At the time of the contract, unbeknown to either of them, the yacht had been wrecked. The yacht was wrecked by a storm the day before the agreement was made. What is the status of this contract?
3. Troy owns two motorbikes, a Suzuki and a BMW. He agrees to sell his BMW to Chuck for \$20 000. Chuck thinks that he is buying the Suzuki. Does a contract exist between the parties?
4. A person who sounded like and looked like Microsoft chief Bill Gates convinced Brian to accept an invalid cheque for the rare motor vehicle he was selling through the newspaper. The individual with the assumed identity resold the motor vehicle to a third party and then disappeared. Advise Brian whether he can recover his motor vehicle.
5. June signed a document believing it to be a guarantee for her son's personal loan. In reality the document was a promise by June to repay her son's personal loan within twelve months. After twelve months the bank seeks to recover the money from June. What defence could June potentially raise? What are her chances of succeeding with this defence?
6. Mr and Mrs Lee provide a guarantee to a bank over a loan for a motor vehicle purchased by their son Lee. Lee subsequently defaults on his repayments and the bank seeks to enforce the guarantee against his parents. At the time the guarantee was entered into, neither parent had a good grasp of the English language, both were elderly and they received no independent legal advice. Mr and Mrs Lee believed that the extent of their liability was far more limited





than it was. Upon what grounds could it be argued that reality of consent is missing from the guarantee agreement? What would be the likely status of the agreement?

7. Moira has sold her hotel in Melbourne to Doris. The purchase price included an amount of \$50 000 for goodwill. The contract contained a clause providing that Moira should not, within a period of two years from the date of the sale, open another hotel within a radius of three kilometres from the hotel that is the subject of the sale. Would Doris succeed in a court action against Moira if, within one year from the date of the sale, Moira:
- (a) opens a hotel within three kilometres of the former hotel?
 - (b) accepts employment as a hotel manager at a hotel within three kilometres of the hotel?

Give reasons for your answer.

