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11

Contracts

Michael Quilter – Associate Professor, Macquarie Business School, Macquarie University

[11.10] The basic principles of contract law are discussed in this chapter. These apply to purely commercial transactions (such as between a manufacturing business and its supplier), as well as transactions where one of the parties is a consumer (a *consumer* is a person who acquires goods or services for personal or household use). Contract law provides a framework to help resolve disputes and enforce rights and obligations. It supports economic growth by giving individuals and businesses the predictability and confidence to trade, associate and invest.

The development of contract law

[11.20] Contracts under common law

Contract law is largely a product of the common law – it has been developed by the courts rather than by parliament passing laws.

A basic common law principle is the assumption that a contract is a bargain made freely between equal parties (*freedom of contract*). Because of this, courts have been unwilling to set aside or alter contracts except in limited circumstances. In the common law, even where there has been unfairness or sharp practice, the principle of *sanctity of contract* has generally prevailed, and contracts have been upheld.

[11.30] Modern consumer issues

These days the assumption that contracts are freely made by equal parties no longer applies in the consumer context, and here parliament has intervened to protect consumers.

Unequal bargaining power

In the modern marketplace, most consumer goods and services are manufactured, marketed and sold by large businesses with access to expertise and resources far greater than those available to the ordinary consumer. There is usually a marked inequality of bargaining power between the parties, not the equality that contract law has traditionally assumed.

Limited bargaining opportunity

In practice, there is usually little opportunity for bargaining – goods and services are typically offered to the consumer on a "take it or leave it" basis, under a standard form contract (where the contract is in writing).

[11.40] Consumer legislation

To some extent, the common law of contract has evolved to take account of these marketplace developments.

The major force for change, however, has come not from the courts but from state and federal parliaments. Particularly since the 1970s, parliaments have introduced a wide range of laws designed to protect consumers and enhance the rights and remedies available to them.

The most important general consumer protection laws, such as the *Australian Consumer Law* (Cth), as well as more specific consumer protection legislation (such as the *Motor Dealers and Repairers Act 2013* (NSW)), are discussed in Chapter 10, Consumers.

The careful consumer

Avoiding problems is better than trying to fix them. Problems in contracts can often be avoided by taking a few practical steps:

- thinking about what you want the product to do, or if you are entering a contract for the provision of a service, the outcome you expect at completion of the work;
- seeking advice or having an expert check the product, or with the provision of a service, getting a second opinion;
- shopping around for the best deal, comparing quality and price;
- inspecting goods carefully, or with the provision of a service checking references or viewing previous jobs.

A good source of information is *CHOICE*, an information body for Australian consumers (www.choice.com.au).

Read before you sign

Consumers should also be careful about signing documents (whether described as contracts, offer forms, order forms, authorisations or whatever) without reading them and, if in doubt, get advice about them. Although consumer protection laws can assist unfairly treated consumers in certain circumstances (see Chapter 10, Consumers), in many cases once a contract is signed it is very difficult to avoid its consequences.

Essentials of a valid contract

[11.50] A contract is a legally binding agreement – that is, the law will enforce it. For a contract to be valid (and thus enforceable), a number of requirements must be satisfied:

- There must be a *concluded agreement* between the parties; this usually involves the acceptance of an offer.
- The parties must have the *intention* that their agreement be legally binding.
- Some benefit or value (*consideration*) must be given by each party in exchange for the other party's promise to do, or not do, whatever the agreement requires.
- The terms of the agreement must be *certain*, so that it is possible to work out what the parties intended their words to mean.
- The parties must have the *legal capacity* to enter into the contract.
- Some types of contracts must meet certain *formal requirements*; for example, a contract for the sale of land must be in writing.
- Each party's *consent* to the agreement must be genuine. The contract's validity may be affected by one or more factors that the courts regard as *vitiating* (removing any real consent between the parties).
- The person seeking to enforce the contract must be a party to it (there must be *privity of contract* between the parties).
- To the extent that the objects or purposes of the contract are contrary to law, the court will not enforce it (*legality of contract*).

These elements are considered in detail below.

[11.60] Agreement between the parties

Offer and acceptance

There is a concluded agreement between parties when one party has made an offer to do (or not do) something and the other party has:

- unconditionally accepted that offer; and
- communicated acceptance to the first party.

Most consumer contracts are formed in this way. The agreement does not have to be in writing or even stated; the parties can satisfy the conditions by their actions. For example, when a person buys goods from a shop, handing over money constitutes the offer by the consumer to buy particular goods, while taking the money constitutes acceptance of the offer by the shop.

Offer and counter-offer

If A makes an offer and B, instead of accepting it, responds with a counter-offer, there is no agreement as yet. If A accepts B's counter-offer, there is an agreement.

Consumer contracts are often formed in this way. For example, when someone buys a car, the price (and possibly other terms) is usually agreed after a number of counter-offers have gone back and forth between the parties.

Revoking an offer

Before an offer is accepted, there is no legal obligation on either party, and each is free to decide not to go ahead with the deal. Therefore, an offer can be withdrawn (*revoked*) at any time before it is accepted, as long as the withdrawal is communicated to the other party.

The offer, if it is in writing, often specifies how the withdrawal must be communicated; for example, that the offer may only be revoked by notice in writing (communicating withdrawal of an offer in writing is sensible anyway).

Rejecting an offer

An offer may be rejected by words or actions. Once rejected, it terminates automatically, and the person who made it is under no obligation to go ahead if the other party changes their mind and decides to accept. A counter-offer acts as a rejection.

How offers are made and accepted

There are a number of technical rules about offer and acceptance but, generally, an *offer* is made if the person making it is prepared to be bound without further negotiation on terms. A person to whom an offer is made *accepts* it if, in response to the offer, they unconditionally promise to do what the terms of the offer require, and communicate this acceptance to the person who made the offer.

Conditional contracts

The parties may reach an agreement but make it subject to a certain event occurring, and until it does there is no contract and no obligation on the parties. If the event does not occur, the parties do not have to go ahead with the contract.

A common example of a conditional contract is an agreement to purchase goods "subject to finance". If the buyer cannot obtain finance, they do not have to purchase the goods.

Note, however, that conditional contracts often contain terms requiring one or both parties to take reasonable steps to do what is required to allow the contract to be completed (eg, take reasonable steps to obtain finance).

Unilateral contracts

Generally, contracts are *bilateral*; each party promises to do or not do something. However, there is also a class of contracts under which only one party promises to do something. These are known as unilateral contracts.

Offering a reward

The reward situation demonstrates a unilateral contract. For example, if A offers a reward for the return of a lost dog, B is unlikely to promise to find and return the dog. However if, in response to the offer, and before the offer is revoked, B does find and return the dog, the contract is now complete. B has accepted the offer by performing the very act which A requested, and A is now bound to pay the reward.

Are advertisements offers?

The general rule about things such as advertisements, catalogues and shop displays is that they are not offers by the seller but "invitations to treat" – an indication that the seller is willing to consider offers to purchase the goods at the advertised price. The contract is formed not when the consumer offers the advertised price, but when the seller accepts the money. This means that the seller can refuse the buyer's money without being in breach of contract if, for example:

- the price has gone up since the advertisement;
- the goods are no longer in stock;
- the price was wrongly stated;
- the seller simply no longer wants to sell the goods.

Although the consumer has no remedy against the advertiser in contract law, there may be other remedies available under consumer protection laws. See Chapter 10, Consumers.

[11.70] Intention to be legally bound

The second element necessary for a valid and enforceable agreement is that the parties intend that the agreement should be legally binding. This intention is rarely stated, but can be inferred from the circumstances. The intention is present in commercial transactions and in ordinary consumer transactions.

Agreements between relatives or friends

The law does not generally assume that relatives or friends intend their agreements to be contracts. For example, if A agrees to lend her car to her niece for a week in exchange for the niece helping her paint her house, then changes her mind, it is unlikely that the court would find that the parties intended their agreement to be legally binding and enforceable by the court.

However, if it can be established that they did intend their agreement to be legally enforceable, the law will treat it as such. In some circumstances, the court may be convinced that even related parties did intend to create legal relations; for example, where an agreement is made between a divorcing husband and wife, or between a father and daughter who do business with one another. Instances where a person has forgone a financial opportunity, or incurred expense as the result of an offer by a relative or friend, may also result in a court finding the requisite commercial intention.

[11.80] Consideration

Generally, the law of contract does not enforce promises made without the expectation of any return. Unless the contract is a *contract under seal* or *deed* (see Contracts under seal or deed at [11.80]) to be enforced, it requires that B gives

consideration – something of value – in exchange for A's promise to perform the contract.

For an ordinary consumer transaction, the consideration is simply the price the purchaser agrees to pay for the product or service.

Who must receive the consideration?

While the agreed consideration must be given by the person receiving the benefit of the promise, it need not necessarily be given *to* the promise-maker. For instance, an agreement whereby A promises to pay B a sum of money if B renovates C's house will be regarded as being supported by consideration and will be enforceable by both A and B (assuming the other elements of a valid contract are present), but not by C.

What is valid consideration?

As long as the agreed consideration is given for A's promise, it does not matter whether it reflects the usual or market value of what A has promised to do, or not do; even a token or "peppercorn" consideration, if that is what has been agreed, is enough.

What is not valid consideration?

There is no valid consideration where the "consideration" is:

- so vague as to be meaningless;
- merely the performance of an existing legal duty – something A is legally obliged to do anyway; or
- a promise to compensate for something already done without expectation of payment – a promise made after the performance of an act (*past consideration*).

Contracts under seal or deed

If there is no consideration (ie, one party agrees to give something but receives nothing in return), the agreement can still be made legally binding if it is in the form of a *contract under seal* or *deed*. In most cases (not all), a deed is enforceable like an ordinary contract.

[11.90] Legal capacity to enter contracts

Some people's capacity to enter into valid, enforceable contracts is limited by law.

Intellectual disability or mental illness

A person with an intellectual disability or mental illness is legally capable of entering into a binding contractual arrangement. However, the person can have the contract set aside if they can show:

- that they were incapable of understanding the nature of what they were agreeing to when the contract was made; and
- that the other party knew or ought to have known of their disability or condition.

The required level of understanding varies according to the nature and complexity of the contract. For example, a person may have the capacity to understand a contract to buy goods from a supermarket, but not to understand a mortgage.

The ability to have a contract set aside on the basis of disability or mental illness may be lost if, at a time when the person has recovered their mental capacity, they show by words or conduct that they intend to continue with the contract.

Requirement to pay for necessaries

Even where the contract is set aside, the person is still liable to pay a reasonable price for any goods or services provided if they can fairly be regarded as "necessaries" (both at common law and under the *Sale of Goods Act 1923* (NSW), s 7).

Goods are necessaries if they are suitable to the "condition in life" of the person ordering them and to the person's actual requirements at the time of sale and delivery.

Intoxication

Considerations similar to those applying to a person with intellectual disability or mental illness apply to a person who was intoxicated by alcohol or drugs at the time of entering into the contract.

Minors

In NSW, a person has full capacity to enter into a contract when they reach 18 (the *age of majority*).

People under 18 are *minors*. Contracts entered into by minors are covered by the *Minors (Property and Contracts) Act 1970* (NSW). In general, a contract made by a minor will be binding from the outset if:

- it was for the minor's benefit when it was entered into (s 19); and
- the minor knew they were making a legally binding agreement (s 18).

If these two conditions are met, the minor will not be able to get out of the contract simply because they were under 18 when it was made.

Repudiating a contract

Repudiation is also covered by the *Minors (Property and Contracts) Act*. If the contract was not for the minor's benefit when it was entered into, or the minor did not understand what was done, the minor can end the contract (*repudiate* it) by serving a signed written notice on the other party (s 33), if:

- the contract is not for the minor's benefit at the time of repudiation (s 31);
- the minor did not *affirm* the contract after turning 18 (ie, show by words or actions that they wish to continue with it) (s 30); and
- the repudiation occurs before the minor turns 19 (s 31).

The critical period is the year after the minor's 18th birthday. The right to repudiate is lost once:

- the contract is affirmed; or
- the person turns 19.

Settling disputes

If there is a dispute about the effectiveness of the repudiation, or about money paid or goods or services received before repudiation, either party can apply to the court (the Local, District or Supreme Court, depending on the amount in dispute – see Chapter 1, About the Legal System and Chapter 14, Criminal Law).

The court can:

- confirm the contract (decide that the repudiation has no effect); or
- order each party to compensate the other for goods or services received so that, as far as possible, they are in the same position as they were before the contract was made (*Minors (Property and Contracts) Act*, s 37).

A party will rarely be entitled to the return of property previously transferred under the contract.

Bankrupts

The *Bankruptcy Act 1966* (Cth) restricts bankrupt persons obtaining credit or entering into contracts for goods or services involving an obligation to pay more than a certain amount (ss 269, 304A) without informing the other party of the bankruptcy. However, the person's general capacity to enter contracts is not lost because of bankruptcy.

[11.100] Formal requirements

There is no general requirement that a contract be in writing, and oral agreements, that meet the requirements for a valid contract, will be enforced by the courts (although where the terms of a contract are in writing they will be more easily identified and provable). However, some contracts are not legally binding unless they meet certain formal requirements. For example, some must be in writing, including:

- agreements for the sale and purchase of land (see [27.800] in Chapter 27, Housing);
- credit contracts (see Chapter 13, Credit).

[11.110] Genuine consent

Sometimes a contract will not be upheld because there was a lack of genuine consent on the part of one (or more) of the parties.

Mistake

Generally, a person must fulfil their obligations under a contract even if they made a mistake (about, perhaps, the quality of goods bought under the contract).

However, if the person makes a *mistake of fact* of a particular kind, the contract may be *void* (in effect, there is no contract) or *voidable*. The types of mistake that have this effect are discussed below.

Common mistake

In the *common mistake* situation, both parties are under the same misapprehension (eg, A sells goods to B which have been destroyed, but neither A nor B is aware of this).

Mutual mistake

In the *mutual mistake* situation, the parties are at cross-purposes about the subject matter of the transaction (eg, A thinks he is buying a particular table while B thinks she is selling him a quite different table).

Unilateral mistake

In the *unilateral mistake* situation, one party is mistaken about the terms of the contract or the identity of the other party and the other party knows this, or ought to know it.

Non est factum

In the *non est factum* ("it is not my deed") situation, a person signs a document fundamentally different in character from what they thought they were

signing (eg, A signs a document giving B an option to buy A's property, under the impression that it is an authority to enter and inspect the property).

This defence is only available where:

- the person had no ability to understand what they were doing; and
- allowing the defence would not be unjust to the other party.

Successful *non est factum* claims are very rare.

Rectification of a written contract

Rectification of a written contract is allowed where an obvious mistake or "slip" has been made when a previously complete agreement is put into writing.

Misrepresentation

The common law doctrine of misrepresentation applies to statements that induce a person to enter into a contract (in contrast to statements forming part of the contract itself). Common law misrepresentation is established where the statement:

- relates to a matter of fact (not law, future intention, or opinion); and
- is false; and
- is made with the intention of persuading the other party to act on it; and
- is one of the circumstances inducing the other party to enter into the contract.

If misrepresentation is established, the person may be able to rescind (get out of) the contract. They may also have a right to claim damages (financial compensation) for any loss suffered as a result, but only if the other party acted either *fraudulently* or *negligently*.

Fraudulent misrepresentation

The conduct of the person making the statement may have been fraudulent if:

- they knew it was false when it was made; or
- they didn't care whether it was true or not (it was made "with reckless indifference").

Fraudulent misrepresentation requires a high degree of proof and is difficult to establish without strong evidence.

Negligent misrepresentation

If the person making the statement was in a special relationship with the other party which meant that they had a duty to ensure that the statement was true, their conduct may have been negligent. Such a duty arises when:

- the person making the statement could reasonably be expected to foresee that the other party would rely on it; and
- it was reasonable for the other party to rely on it in the circumstances.

Innocent misrepresentation

The misrepresentation is *innocent*, and no damages can be claimed, if the person making the statement:

- did not know it was false;
- was not careless about its truth; and
- was under no duty to ensure its truth.

Consumer protection legislation

The common law doctrine of misrepresentation has been largely replaced as far as consumer contracts are concerned by consumer protection legislation (the "*Australian Consumer Law*") in both federal and NSW jurisdictions (see Chapter 10, Consumers).

The common law doctrine is still relevant however, but only where the legislation does not apply to the particular transaction in question.

Undue influence

The doctrine of *undue influence* is relevant if someone enters into an agreement, but their decision to enter into that agreement was not a free and independent decision due to the undue influence of another person.

This doctrine can generally be relied on only when someone has entered into an agreement that is clearly not in their interests.

Onus of proof

In certain relationships (such as parent and dependent child, trustee and trust beneficiary, solicitor and client, religious adviser and follower, doctor and patient), the onus of proof rests with the dominant party to show that the transaction was not the result of undue influence.

In other relationships (such as husband and wife), the onus of proving the claim rests with the party claiming to have been unduly influenced.

Duress

Undue influence applies where a person's will is overcome. *Duress* applies in the more extreme situation where someone enters a contract against their will in response to such things as actual or

threatened violence or unlawful imprisonment. The threats or violence may be directed against the person signing, a family member or someone else with whom they are closely connected. In some cases, duress may take the form of illegitimate economic pressure upon a person in business to enter a contract against their wishes.

Duress is hardly ever relevant to consumer transactions. It is often appropriate to refer a situation involving duress to the police.

Unconscionable dealing

According to case law in this area, the *unconscionable dealing* doctrine applies where:

- one party is at a "special disadvantage" or under a "special disability"; and
- the stronger party knew about it, or ought to have known about it; and
- the stronger party takes advantage of the weaker party's special disadvantage in a way which is not consistent with good conscience.

Special disadvantage or special disability

A person may be at a special disadvantage or special disability because of age, illness, inexperience, ignorance, impaired faculties, drunkenness, illiteracy, or other circumstances or combination of circumstances.

The disadvantage must be special, not just the disadvantage of unequal bargaining power. It must seriously affect the person's ability to look after their own interests.

Evidence of unconscionable dealing

The focus is on whether the *circumstances* of the negotiations were unconscionable (*procedural unconscionability*), rather than whether the *terms* of the contract are unconscionable (*substantive unconscionability*). Harsh or unreasonable terms (from the weaker party's point of view) may, however, suggest that unconscionable dealing has occurred.

Consumer protection legislation

The doctrine has been extended, in the case of consumer contracts, by legislation prohibiting unjust contracts and unconscionable conduct (see Chapter 10, Consumers).

[11.120] Privity of contract

Only a party to a contract can enforce it or have it enforced against them. This is called the *doctrine of privity*.

A person who did not directly participate in dealings leading to a contract may still be a party to it if the person who negotiated it acted on their behalf as an agent or through a power of attorney.

[11.130] Illegal contracts

As a matter of public policy, the courts will not enforce contracts that are illegal. Examples are:

- contracts to commit:
  - a crime;
  - a civil wrong;
  - a fraud on a third person;
- contracts to fraudulently avoid paying government taxes and charges;
- contracts harmful to:
  - public safety;
  - the administration of justice;
  - public life generally;
- contracts for a sexually immoral purpose.

The courts will also refuse to enforce a contract to do anything prohibited by statute.

The effect of entering a contract

A contract is formed when an offer is accepted (when the essentials of a valid contract exist – see [11.50]), and from that moment the parties are legally bound to perform their obligations. The terms of the contract can be changed only if all parties agree to the changes. If a party fails to carry out their obligations, they will be "in breach of contract", and the other party may be entitled to end the contract and/or be compensated for the breach.

The terms of a contract

[11.140] A contract basically consists of various promises made by the parties; for example, A promises to deliver certain goods to B, and B promises to pay A a certain sum of money. These promises are known as the *terms* of the contract.

[11.150] Express and implied terms

The terms of a contract may have been expressly agreed to by the parties or they may be implied.

Express terms

If the contract is oral, then the express terms will be those actually used by the parties at the time of formation of the contract. If the contract is in writing, the express terms will be those set out in the written document.

Implied terms

Apart from the express terms in a contract, certain other terms may be implied or included into the contract by:

- a court (such as the need to imply terms that make sense of or give effect to the parties intentions – "business efficacy");
- custom or trade usage;
- legislation.

Terms implied by legislation

The most important implied terms for consumers are those in consumer protection legislation, which may imply conditions about quality, fitness for purpose, and the exercise of due care and skill into various types of consumer contracts (see Chapter 10, Consumers).

[11.160] Written and oral terms

The terms of a contract may be in a document (signed or unsigned), or in oral statements, or may be partly written and partly oral.

Documents that are not signed

When the terms of a contract are in writing but not signed (eg, the terms on the back of a ticket or on a sign in a store), they are considered to be part of the contract if the party wishing to enforce them can show that either:

- the other person knew they were there; or
- reasonable steps were taken to draw the terms to the person's attention before the contract was made.

[11.170] Conditions and warranties

At common law a term of a contract may be either:

- a *condition*; or
- a *warranty*.

A condition is a term without which there would be no contract. It goes to the heart of the contract. A warranty is a term dealing with a less important aspect of the contract.

Why it matters

Whether a term is a condition or a warranty can be important if there is a breach of contract. The breach of a condition entitles the party not at fault to terminate the contract, whereas a breach of warranty only gives a right to sue for loss or damages (see [11.250]).

[11.180] Exclusion clauses

It is quite common for traders to put an *exclusion* (or *exemption*) clause in a contract that excludes or limits their liability for defects in goods or for damage done to the consumer or their property by, or as the result of the use of, the goods. These clauses are almost always contained in a written document, which may or may not be signed.

In a signed document

If a document containing an exclusion clause is signed, the clause becomes part of the contract.

In an unsigned document

If there is no signed document, the person seeking to rely on the exclusion (in consumer transactions this will be the trader) must show that the other party was aware of the clause, or that steps were taken to draw the exclusion clause to the other party's attention before the contract was made – that is, before the offer was accepted (see [11.160]).

A common exclusion clause

A person drives into a parking station and takes a ticket from a machine. There is a contract; an offer has been made by the parking company and accepted by the driver. If there is a clause on the ticket excluding any responsibility for damage to the car while it is parked however, it will probably only be effective if the company took reasonable steps to draw attention to it before the driver completed the contract by taking the ticket (eg, by a sign at the entrance).

What cannot be in an exclusion clause

The *Australian Consumer Law* implies a number of "guarantees" – such as fitness for purpose and acceptable quality – into all consumer contracts. Terms in consumer contracts which purport to exclude these guarantees are void. However, terms may "limit" liability for breach of such guarantees, so long as the limits are fair and reasonable (*Australian Consumer Law*, s 64A).

[11.190] Cooling-off periods

A *cooling-off period* is a time after a contract is made in which a party can decide not to go ahead with the contract, without penalty or with a minimal penalty only.

Right to a cooling-off period

There is no general legal right to a cooling-off period, and only a few areas where the right is conferred by statute.

Statutory cooling-off periods

Statutes that provide for cooling-off periods include the:

- *Conveyancing Act 1919* (NSW) (a five business day cooling-off period in contracts for land purchase (s 66S), which can be excluded if the parties agree and the purchaser has received legal advice (s 66W));
- *Motor Dealers and Repairers Act 2013* (NSW) (a one-day cooling-off period for car purchases where a dealer has provided or arranged credit (s 80), which can be excluded, or extended, if the parties agree. A decision to terminate must be in writing, and the purchaser must pay $250 or 2% of the price (s 85));
- *Corporations Act 2001* (Cth) (a 14-day cooling-off period in relation to "financial products" (defined in s 763A), including investment and insurance (s 1019B)).

A cooling-off period as a term in a contract

The parties can agree to include a cooling-off period as a term of the contract. In standard consumer transactions, this is very rare.

Ending a contract

[11.200] A contract may be *discharged* or *terminated* in a number of ways.

[11.210] By performance

The contract ends automatically when the parties have carried out all their obligations.

[11.220] By agreement

Termination specified in the contract

The contract itself can specify that it will end:

- at a particular time (eg, a contract to rent a fridge for six months); or
- because of the occurrence (or otherwise) of a specified event (eg, an agreement to buy a car may include a provision that the contract terminates if the buyer cannot obtain finance).

New contract of termination

The parties can agree to end the contract at any time after it has been made. This agreement is also a contract, and all the elements listed at [11.50] must be present, including consideration.

Consideration in the new contract

Where both parties still have obligations under the old contract, the new contract will consist of promises by each party not to enforce the promises made under the old contract, so each receives something of value.

If one party has already performed their obligations but the other has not, there may not be enough "consideration" to make the agreement legally binding. The other party must give something of value; or alternatively the agreement could be documented as a *deed* (see Chapter 1, About the Legal System).

[11.230] By frustration

Sometimes, after the parties have entered into the contract, an unforeseen event occurs that results in a situation fundamentally different from that which the parties had in mind when the contract was made; for example, the contract is

for a personal service and the person who was to perform it dies.

In such cases, the law regards the agreement between the parties as having been *frustrated* and at an end. In NSW, such agreements come under the *Frustrated Contracts Act 1978* (NSW).

In some cases, a party might be able to claim compensation for an obligation that was supposed to be performed before the contract was frustrated but was not performed (s 7).

Where one party has fulfilled their part of the contract and has not received any benefit from the other – for example, by paying for something that was then destroyed – the other party may be required to return the money (ss 10, 11).

[11.240] By repudiation

Where one party by word or act indicates, either before or during performance of their obligations under the contract, that they are not willing to perform or continue performing those obligations, that party is said to *repudiate* the contract.

Repudiation by one party gives the other the right to terminate the contract and sue for damages. For example, if A agrees to sell a car to B, then sells it to C who has made a better offer, A has repudiated the agreement with B who can immediately terminate the contract and sue A for any loss suffered as a result of the repudiation.

[11.250] By breach

The contract may come to an end if one party commits a serious *breach of contract*.

A party who fails to carry out an obligation under a contract is in breach of contract. This may happen in various ways (eg, when a retailer supplies defective goods or a borrower makes a late payment). The consequences depend on the seriousness of the breach and the terms of the contract.

Certain breaches give the innocent party the right to terminate the contract immediately and to sue for damages suffered as a result of the breach. In other cases, the innocent party has no right to terminate, but can claim damages.

Right to terminate the contract

If one party breaches a contract, the other party does not automatically have a right to terminate it. This right is only available if:

- it is provided for in the contract; or
- the breach is sufficiently serious.

Where the right is contained in the contract

Some contracts contain a term giving one party the right to terminate following a particular kind of breach (or any breach) by the other party. Any clear provision to this effect is decisive.

Where the breach is serious

Where the contract has no term giving a party the right to terminate the contract following a breach, only a serious breach will give the other party a right to terminate. A serious breach is:

- a breach of a condition or fundamental term (a term is fundamental if the other party would not have entered the contract unless they believed it would be fulfilled);
- a breach that substantially deprives the other party of what they intended to obtain under the contract.

A party who decides to terminate a contract for breach should notify the other party immediately. The right to terminate can be lost by delay, leaving the innocent party with only a right to damages.

Effect of the termination

Termination of the contract means that both parties are released from their future obligations, but any rights which either party already had (such as the right to be paid compensation for the breach) remain.

Has a breach occurred?

It can sometimes be hard to decide whether a breach has occurred and whether it gives rise to a right to terminate (either at law or under the contract). A person should not attempt to terminate a contract unless they are certain that:

- the other party has committed a breach; and
- this breach gives them the right to terminate.

Termination without legal entitlement

Someone who attempts to terminate a contract when they are not legally entitled to do so commits a serious breach and could be liable to pay damages to the other party.

Damages

The innocent party is generally entitled to compensation for losses suffered due to a breach of contract. However, not every loss caused by a breach will be compensated.

If it can be shown that the party in breach should have realised when they entered the contract

that the sort of loss suffered (if not its extent) was reasonably likely to result from the breach, compensation will be payable. Unusual losses will only be compensated if it was clear at the time of contracting that a special loss might occur in the circumstances of the case.

Damages are awarded for breach of contract with the general aim of putting the innocent party in the position they would have been in if the contract had been properly performed.

Damages clauses in the contract

The contract may indicate the damages to be paid or how damages should be calculated, if there is a breach.

Pre-estimates of loss

An agreed amount of damages for a breach must be a genuine pre-estimate of the likely loss that would result from the breach. This is then the amount to be paid if there is a breach, regardless of the actual loss. Where the agreed damages are not really a pre-estimate of loss, and are in fact a penalty for breaching the contract, the amount of damages is limited to the actual loss suffered rather than the agreed amount.

Where payment is by an initial deposit, followed later by the balance, the contract may provide that the damages will amount to the loss of the deposit.

Where there is no provision for damages

If there is nothing in the contract about the amount to be paid, the party claiming damages must show the actual amount of the loss caused by the breach.

The duty to mitigate

When there is a breach of contract, the innocent party has a duty to take all reasonable steps to minimise their losses (*mitigation*). If the party in breach can show that the innocent party suffered a loss that they could reasonably have avoided, the loss will not be compensated.

For example …

A homeowner employs a plumber to fix a pipe, but the next day the pipe springs a major leak. The homeowner tries to contact the plumber without success for three days. By the time the plumber is informed of the problem, major water damage has occurred.

The plumber will be able to argue that the homeowner should have employed another plumber to fix the pipe in the meantime, which would have greatly reduced the damage caused by the leak. If this argument succeeds, the homeowner will only be entitled to compensation for the initial damage, not for the damage occurring as a result of the delay in having the work repaired.

Compelling performance

Under general contract law, it is rare for a court to make an order requiring the party in breach to perform the contract, as damages are usually considered adequate compensation. Contracts for the sale of land are an exception. In such contracts, the court may order the party in breach to carry out the contract and complete the sale.

In contrast to the position under the general law, specific performance type remedies are available under various statutory consumer protection laws (see Chapter 10, Consumers).

Contact points

[11.260] If you have a hearing or speech impairment and/or you use a TTY, you can ring any number through the National Relay Service by phoning **133 677** (TTY users, chargeable calls) or **1800 555 677** (TTY users, to call an 1800 number) or **1300 555 727** (Speak and Listen, chargeable calls) or **1800 555 727** (Speak and Listen, to call an 1800 number). For more information, see www.communications.gov.au.

Non-English speakers can contact the Translating and Interpreting Service (TIS National) on **131 450** to use an interpreter over the telephone to ring any number. For more information or to book an interpreter online, see www.tisnational.gov.au.

Changes are expected to the websites for many NSW government departments that were not available at the time of printing. See www.service.nsw.gov.au for further details.

Australasian Legal Information Institute (AustLII)
www.austlii.edu.au

Australian Competition and Consumer Commission (ACCC)
www.accc.gov.au
ph: 9230 9133
Infoline: 1300 302 502

Association for Data-Driven Marketing and Advertising (ADMA)
www.adma.com.au
ph: 9277 5400

Australian Retailers' Association
www.retail.org.au
ph: 1300 368 041

Australian Securities and Investments Commission (ASIC)
www.asic.gov.au
ph: 1300 300 630

CHOICE
www.choice.com.au
ph: 9577 3399 or 1800 069 552

Department of Justice (NSW)
www.justice.nsw.gov.au/

Financial Rights Legal Centre
www.financialrights.org.au
ph: 9212 4216
National Debt Helpline: 1800 007 007

Law and Justice Foundation of NSW
www.lawfoundation.net.au

Legal Aid NSW
www.legalaid.nsw.gov.au

Australian Consumer Law
www.consumerlaw.gov.au

NSW Civil and Administrative Tribunal (NCAT)
www.ncat.nsw.gov.au
ph: 1300 006 228

NSW Fair Trading
www.fairtrading.nsw.gov.au
ph: 13 32 20 or 9895 0111

Australian Financial Complaints Authority
www.fos.org.au
ph: 1800 367 287

Public Interest Advocacy Centre
www.piac.asn.au
ph: 8898 6500

Standards Australia
www.standards.org.au
ph: 1800 035 822

Telecommunications Industry Ombudsman (TIO)
www.tio.com.au
ph: 1800 062 058