

Chapter Three

The Law of Contracts

Learning Outcomes

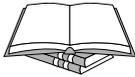
1. Define contract.
2. Explain the role of contracts in commercial and other relationships.
3. Explain the six elements in the formation of a contract.
4. Explain the consequences of breaching a contract.
5. Illustrate some common contract usage in the hospitality and business fields.

Introduction

A **contract** is a written or oral (or partly written and partly oral) promise exchanged for another promise or for a performance that the law will enforce. If the law will not enforce it, then it is not a legally binding contract. Contracts are indispensable tools of business and other human interactions. They lend a degree of predictability to matters that would otherwise be fraught with uncertainty. Even the relatively simple economic activity of barter involves the six essential elements of the formation of a contract: offer, acceptance, consideration, intention, capacity, and legality. For those in business, an understanding of the legal requirements and the effects of contracts is critical. Without such knowledge, a businessperson runs a high risk of forfeiting benefits bargained for and of being liable for unexpected obligations.

Unilateral and Bilateral Contracts

In a unilateral contract, one party provides a promise and the other party provides a performance. The **promissee** fulfills the bargain simply by supplying the performance requested. There is no need to notify the promisor in advance. For example, a hotel manager might place a notice in the hotel's front window announcing that the hotel will pay \$1,000 to anyone who climbs the flagpole and rescues the hotel's resident cat. Would-be rescuers need not notify the manager of their intention to perform; they need only perform. Upon delivery of the cat to the manager, the intrepid climber becomes entitled to the money as promised.



Carlill v. Carbolic Smoke Ball Company, [1892] 2 Q.B. 484

Carbolic placed an advertisement promising to pay £100 (a large sum in the 1890s) to anyone who caught the flu despite using the company's smoke balls in the manner prescribed. Carlill used the smoke balls as specified and still caught the flu. She successfully sued Carbolic on the basis that she had performed her part of the bargain and that advance notice of her performance was not necessary.

Unilateral (one-way) contracts feature an exchange of a promise for a performance. Bilateral (two-way) contracts feature an exchange of a promise for a promise. Of course, the bilateral promises still have to be performed, but the exchange of the bilateral promises brings into existence the contract that the parties then perform. With bilateral contracts, the exchange of promises brings the contract into being before the performance (which may not occur for months); with unilateral contracts, the performance itself brings the contract into being. Until the performance occurs in a unilateral contract, there is no contract. Whether the contract is unilateral or bilateral, once the performance is completed, the performer is entitled to fulfillment of the balance of the contract (i.e., receipt of the benefit of the originating promise). Most contracts are bilateral. Multilateral contracts follow the rules pertaining to bilateral contracts.

Invitations to Treat

The phrase "**invitation to treat**" means that one person is inviting other persons to make an offer. The invitation to treat is not an offer, but merely an invitation to someone else to make an offer. For example, a restaurant invites customers to treat by presenting a menu. The offer is made when the customer offers money for food. The offer is

accepted when the restaurateur agrees to supply the food. The payment terms are usually tacitly understood to be the amount shown on the menu; however, nothing in law stops the customer from offering to buy the item for less than the price on the menu. Equally, nothing stops the restaurant from refusing the low offer.

Advertisements that are not the originating component of unilateral contracts are not offers, but are invitations to interested persons to make an offer. When a bistro advertises its meatloaf at a special price, the bistro is not promising to supply every possible reader of the ad with a meatloaf at that price. It is understood that only a limited number of meatloafs are available at the special price. Similarly, hotels often advertise a range of room rates, but have only a limited number of rooms in each range. The first guests to claim the rooms receive them at the advertised rate. Guests who have not made reservations may find that all the specially priced rooms have been taken. Such advertisements are not misleading because it is understood that no hotel has an unlimited number of rooms for an unlimited number of potential guests. The advertisement would be misleading only if the lower-priced rooms were never available, or if it referred to “rooms” when only one lower-priced room was available.

Although it is often present, an invitation to treat is not an essential element of a contract. A consumer who does not see a menu or a list of room rates may nevertheless make an offer to buy the goods or services without first having been invited to make an offer.

The Six Essential Elements of a Contract

Offers

The first of the six essential elements of a contract is the offer. An offer is tentative until it is accepted. A tentative offer is made when a potential guest informs the desk clerk that he or she is interested in renting a room.

An offer may be conditional. The offer is binding during the conditional period. If the conditions are met or waived, the contract becomes firm. If the conditions are not met or waived prior to the expiry date of the conditions, the offer is no longer binding. Most offers stipulate that if there is a failure to meet conditions that the **offeror** will not waive, then the offer will be null and void and any deposit moneys will be returned with (or without) interest.

Lapse

An offer does not remain open indefinitely. It either lapses or is **revoked** if it is not first rejected, accepted, or countered pursuant to law. An offer lapses when:

1. the **offeree** fails to accept the offer by a deadline;
2. the offeree fails to accept the offer within a reasonable time if there is no deadline; or
3. a party dies, becomes mentally incompetent, or otherwise loses the capacity to make contracts prior to acceptance.

The first instance of lapse is clear. If an offer sets a deadline for acceptance and none is received by that time, the offer lapses. The second instance of lapse is not so clear. If the offer sets no deadline for acceptance, the offer will be good only for a reasonable time. The definition of “reasonable” depends on the subject matter of the contract and the expectations of the parties. An offer to buy a shipment of bananas will have a shorter term than an offer to buy 400 mattresses because the former item (a consumable product) has a shorter life span than the latter item (a durable product). The third instance may also present difficulties. It is not always easy to determine whether a party has lost the mental capacity to make a contract.

Registration is a contractual agreement.



Revocation

An offer may be revoked any time prior to acceptance. Offers may contain a clause making them **irrevocable** for a certain time. Real estate offers and offers to purchase businesses are almost always irrevocable for a few days to give the vendor time to consider whether to reject, accept, or counter the offer from the purchaser.

Options

An **option** is an agreement by the offeror not to revoke the offer for a

given period. Until the option expires, the offeror cannot revoke the offer and must not compromise the offeree's option rights. An option provides time to deliver the offer to the offeree, as well as reassurance to the offeree that the offer will not be revoked prior to the option deadline.

Acceptance, Rejection, and Counteroffer

Acceptance is the second essential element of a contract. Upon being presented with an offer, an offeree may either accept, reject, or counter the offer. Until the offer has been accepted, there is no contract. Acceptance is made by taking a positive and unambiguous step, either verbally or with an act. Acceptance may be effected by performance. A travel agent who wants her office painted may say to a painter, "If you want the job, be here Monday and start painting." If the offeree appears on Monday and starts painting, this establishes his acceptance of the offer. Silence by the offeree cannot constitute a binding acceptance unless the offeree has previously indicated that silence would be a method of acceptance. **Rejection** may be effected by positive communication as well as by silence. Rejection terminates the offer, and any further dealings between the parties must involve a fresh offer.

If an offeror amends a term prior to acceptance, the change revokes the offer and the new proposal becomes a new offer. On the other hand, if an offeree amends a term but otherwise accepts the offer, the offeree has not accepted or rejected the offer, but has made a **counteroffer**. The offeror is now the counterofferee, and must decide whether to accept, reject, or counter the counteroffer. The counterofferee may amend the amendment and return the document to the counterofferor, who then becomes the counter-counterofferee. The contract will be binding (subject to conditions) once the parties have executed the document without further amendments or, in the case of an oral agreement, have agreed to the final terms.

Communication, Timing, and Locality

The offeror chooses the manner of communicating the offer and lives with the consequences of the choice. Consider an offeror who mails the offer and then, prior to receiving the acceptance, revokes the offer. If the acceptance is in the mail postmarked prior to the date of the revocation, then the acceptance is complete and the revocation

image not available

is invalid. On the other hand, if the offeree accepts an offer using a method of communication that is slower than the manner in which the offer was conveyed, then the offeree must live with the consequences. Consider an offeree who responds by mail to a faxed offer from the offeror. If the offeror revokes the offer by fax prior to the arrival of the acceptance in the mail, the revocation will stand. Under common law, an offeree may accept by the fastest method available regardless of how the offer was conveyed. Thus, an offer delivered by mail may be accepted by fax. Unless the contract provides otherwise, the following rules of delivery of acceptance apply:

1. For mail and telegrams, acceptance occurs when and where the acceptance is put in the post or delivered to the telegraph office. The parties will be bound even if the letter or telegram goes missing provided the offeree is able to prove that, within the time for acceptance, the letter was posted or the telegram was delivered to the telegraph office.
2. For instantaneous communications, such as telephone, fax, and e-mail (see "E-Commerce Considerations," page 67), the acceptance occurs when and where it is received by the offeror.
3. The law applicable to the contract is the law of the place where the acceptance occurs.

Although most offers and acceptances are communicated in writing or verbally, there are instances where neither a written nor verbal method is used. For example, on stock market floors, traders use hand signals to buy and sell stocks. Similarly, auctioneers and buyers use signals to enter into purchase and sale contracts.

Consideration, Gratuitous Promises, and Seals

Consideration

Consideration, and seals that stand in place of consideration, constitute the third essential element of a contract. The price a party pays for the promise of the other party is called consideration. While the term "price" suggests a monetary payment,

the consideration need not be monetary in nature. The courts require consideration or a seal but, except in the limited circumstances discussed below, are not concerned whether the deal is fair. In the business world, people are generally assumed to know what they are doing, and if they make a bad bargain, they must live with the result. If Tony offers to sell Carol his car for consideration of \$100 (or her stereo) and she accepts, an enforceable oral contract is created. If he later learns that the car is worth much more and wishes to renege, she can enforce the original promise (unless she brought about his error in assessing the value).

Gratuitous Promises

Promises made without consideration are **gratuitous**, and the failure to perform them generally has no remedy in law. In such a case, there is no contract, and any agreement purporting to be a contract on those terms is void. If Tony promises to give Carol his car next week without seeking anything in return, the promise is gratuitous. Since Tony is not receiving consideration, Carol would have no legal grounds upon which to sue if he later failed to honour his promise.

The gratuitous reduction of a debt is another example of an unenforceable contract. Suppose Tony owes Carol \$100 and the due date has passed. If Carol asks Tony for \$75 stating that she will forgive the \$25, she can still sue for the \$25 once she has the \$75 because there was no consideration given by Tony, or received by Carol, for the debt reduction. There are circumstances in debt reduction in which consideration does arise. If Carol agrees to accept a lesser amount provided she is paid now rather than when the debt is due (say, next month), she is receiving consideration in the form of advanced payment of part of the debt. She may be happy to forgo some debt to recover most of it immediately. Such an arrangement is enforceable, and she would be precluded from pursuing the balance. Forbearing from suing for the balance of a debt is good consideration, and is the basis of many lawsuit settlements.

Under common law, if the promise is gratuitous and a person relies on it to his or her detriment, there is no legal recourse. Thus, if Carol relies on Tony's **gratuitous promise** to give her his car and buys seat covers for it in anticipation, she will not be able to recover the cost of the covers if he reneges on the promise. However, the courts may supersede the common law rule by applying the equitable remedies of injurious reliance or **promissory estoppel** to bind gratuitous promissors to their promises in cases where the promisees, acting reasonably and to their detriment, have been induced to rely on the gratuitous promises. The courts examine whether the promisee reasonably and injuriously relied upon the promise, or whether the promisor is estopped by equitable principles from denying the obligations arising out of his or her promise. In either case, the promisor is bound and the promisee recovers.

Seals

Promises made under the promisor's seal are binding even in the absence of consideration. The seal is a device of document execution dating from the days when only the clergy, lawyers, and scribes were literate. The illiterate (who included kings and queens) pressed their signets onto warm wax to indicate their willingness to be bound by the contents of the document. Consideration is not required because the solemn act of sealing proves the promisor's intention to be bound. This is what was originally meant by the phrase "to seal the deal." Seals are still often employed, but without signets and wax. Today, it is sufficient to write the word "seal" or to affix a red gummed wafer next to one's signature or mark.

Unconscionable Transactions

Courts are concerned with the value of the consideration only when the judge's conscience is scandalized by the transaction. When, by virtue of lopsided bargaining powers, abuse of authority, or breach of **fiduciary** duty, a person manipulates another into a very bad bargain, the courts may set aside the contract as an unconscionable transaction. To be set aside, the transaction must be more than just unfair; it must be unconscionable.

Intention to Create a Legal Relationship

Intention to create a legal relationship is the fourth essential element of a contract. Unless the parties intend to make a contract, there is no contract. The contract may state that the parties intend to be legally bound or the intention may be inferred from the conduct of the parties. Usually, the execution of the contract provides the necessary evidence of intention. Execution occurs when a party places his or her signature or mark on the document, or when a signing officer of a corporation signs on behalf of the corporation. Unless required by statute, witnesses are not necessary, but may be helpful if an issue as to execution later arises.

An enforceable contract is formed when a hostess hires a caterer to cater a party. The agreement between them is intended to bind them legally, thereby giving rise to remedies in law in the event of breach. On the other hand, there is no contract between the hostess and the guests she has invited for dinner. If the caterer fails to supply the dinners to the hostess, the hostess can sue the caterer, but if the hostess fails to supply the dinners to her guests, her guests cannot sue her. The relationship between the hostess and her guests may be based on a written invitation and a sincere intention to feed and be fed, but the hostess and her guests did not intend to create a legally binding relationship. Similarly, two parties who promise to travel together on a holiday do not normally intend to create a legally binding relationship.

Capacity of the Parties

The fifth essential element of a contract is the **capacity** of the parties to enter the contract. If one of the parties lacks the legal capacity to enter into the contract, then the contract may be void or voidable depending on the circumstances and the type of incapacity.

Mental Illness, Substance Abuse, and Senility

Persons who can prove that at the time of making the contract they were incapacitated due to mental illness, substance intoxication, or senility, and that the other party was aware of the incapacity, may **repudiate** or enforce the contract at their option. Upon regaining capacity, the person must repudiate promptly or risk being bound.

Minors

Under common law, a minor is a person under the age of 21. Many provinces have lowered the age of majority by statute. Generally, contracts made by minors are enforceable or voidable at the option of the minor, but not at the option of the other party. However, there are cases where a contract made by a minor is enforceable by the other party. Contracts of employment or apprenticeship that are beneficial to the minor bind the minor. Further, contracts for a necessity of life are enforceable after delivery of the necessity to the minor. If a minor contracts for a room and a meal in a budget hotel when stranded there, the contract is enforceable. The lodging and food are necessities, not extravagances. Other necessities include legal advice, medical treatment, clothing, and reasonable transportation arrangements.

These principles are designed to protect minors, but not to place weapons in their hands. If a minor enters into a contract for a non-necessity and has made some payments, he or she may still void the contract, but will likely not recover money already paid. Upon voiding the contract, the minor will have to return any unused portion of the goods or services remaining in his or her control. Upon reaching the age of majority, an otherwise nonbinding contract that is of an ongoing or continuing nature may become binding on the ex-minor unless he or she repudiates it promptly. If the contract is not of an ongoing or continuing nature, the ex-minor must ratify it promptly. If the contract was void in the first place, it cannot be ratified.

Renting a suite for a school graduation party is not a contract for a necessity. The hotel may prefer to make the contract with the minor's parents, although minors honour their contracts as often as adults do (i.e., almost always).

Agents and Principals

An agent is a person authorized by a principal to enter into contractual relations with other parties on behalf of the principal. If the agent has acted in accordance with the real or apparent authority given to him by the principal, the agent will not be liable to the other party, but the principal will be. If the agent has acted outside the scope of his authority, he will be liable to the principal. If the agent leads the other party to believe that he is acting as a principal and not as an agent, the agent and not the principal will be bound by the contract. If the agent does not inform the other party as to whether he is an agent or a principal, the other party, upon learning that the contract is with an undisclosed principal, may pursue either the agent or the principal. Agency law is discussed in detail in Chapter 15.

Powers of Attorney

A power of attorney is a special form of agency whereby the donor, in writing, grants power to an attorney to act on his or her behalf. Attorney means agent, not lawyer. The donor must be at least 18, mentally competent, and must understand the powers granted. The power may be restricted and may cover property, personal care, and medical treatment. An attorney must act in the best interests of the donor, and is liable to the donor for losses resulting from unreasonable conduct or bad faith. Persons who have not named an attorney run the risk that their affairs will be managed improperly or by a person not of their choosing. Powers of attorney avoid complications, needless legal and other expenses, and government meddling.

Spouses and Cohabitants

Married or not, men and women who cohabit may contract in their own names. As a rule, they are regarded as separate parties with respect to property and liability. In some circumstances, if one spouse conveys property to the other spouse in order to avoid creditors, the property is deemed not truly separate and the conveyance may be set aside.

Business Partners

Partners may bind, and be bound by, other partners. Unless the partner's conduct is outside the scope of a partner's authority to the knowledge of the affected third party, the contractual and tortious conduct of a partner binds the other partners. Unless a former partner has properly retired from the partnership, he or she may continue to be liable. Methods of proper retirement include novation of contracts between the remaining partners and their creditors, and registration of a notice of dissolution of partnership pursuant to provincial regulation.

Corporations

Corporations cannot act except through their authorized officers. It is not necessary to verify whether the officer has proper authority; the officer need only appear to have authority. The officer binds the corporation by signing and affixing the corporate seal to the document or by adding below the signature the sentence "I have authority to bind the Corporation." The use of the seal here is for the purpose of executing the document, not for the purpose of dispensing with consideration (unless that is also the parties' intention).

Native People

Reserve lands cannot be used as security for debts. A disposition of reserve land to anyone lacking reserve rights is void unless it is approved by the federal government. Native persons who reside off the reservations have the same contractual capacity as any other citizens.

Diplomatic Immunity

In general, diplomats posted to Canada are beyond the jurisdiction of Canadian courts. An embassy that fails to pay for the use of a convention hall cannot be forced by Canadian courts to honour its contract. In the rare circumstance in which a foreign government refuses to honour its undertakings, negative publicity may result in the payment being produced. Of course, the implications of such publicity would have to be considered in advance.

Enemy Aliens

In peacetime, aliens (defined by residency, not citizenship) have the same contractual rights as residents of Canada. During hostilities, aliens lose their capacity to contract unless the contract is of clear benefit to Canada or is pursuant to government licence. Contracts with enemy aliens that are against the public interest are void.

Bankrupts

The capacity to contract is reduced for undischarged bankrupts until they are discharged. An insolvent person is not necessarily bankrupt and may continue to contract; however, he runs the risk of punitive court awards against him if further losses are unfairly sustained by others.

Legality

The sixth essential element of a contract is **legality**. Absent legality, there is no contract. The purpose of a contract must not be to break the law or run counter to public policy. If it is, the contract will be either void or illegal and unenforceable. If the contract is void, no contract ever existed, and the courts will try to return the parties to their pre-contract condition. If the contract is illegal, the court will not assist anyone who has entered into it, and the parties' losses will fall where they may, a result that will not necessarily be in the interests of justice. A contract to import banned foodstuffs is illegal. If a party has paid money but the payee has failed to deliver the goods, the payor will not be able to use the courts to seek a remedy.

Other Elements of Contract Formation

Other issues that affect the formation of contracts include the requirement of writing (for some contracts), part performance, the privity rule, exceptions to the privity rule, and risk.

The Requirement of Writing

Except for certain types of contract discussed below, it is not a legal necessity that the contract be in writing. Contracts are binding whether written or oral, or partly written and partly oral. If the oral terms of a contract can be ascertained, then the oral contract is as enforceable as a written one. The main difficulty with oral contracts is proving the terms. Many a friendship and partnership have foundered on innocent (and sometimes not so innocent) misunderstandings about the exact terms of an oral contract. The closer the friendship or partnership is, the more indignant the victim is. Every lawyer has heard the sad cry, "I can't believe they could do that to me." Commonly, both parties make the same lament to their respective lawyers.

Pursuant to the *Statute of Frauds*, the *Sale of Goods Act* and similar provincial statutes, certain contracts are so fraught with potential conflicts over terms that they are not enforceable unless they are in writing. For practical purposes, there are eight types of contracts that must be in writing to be enforceable:

1. Agreements involving an interest in land, such as agreements of purchase and sale, mortgages, and long-term leases
2. Domestic contracts, including marriage contracts, cohabitation agreements, separation agreements, and promises made in consideration of marriage
3. A guarantee of another's debt where the guarantor is not a primary surety of the debt
4. A promise by an estate trustee to pay out of his or her own pocket without reimbursement the debts of the deceased's estate
5. Certain agreements involving minors that must be ratified in writing upon the minor reaching the age of majority
6. Agreements that expressly state that they are not to be performed within one year. If the contract does not expressly so state, it is considered to be for an indefinite term, and need not be in writing under this rule. British Columbia, Manitoba, and Ontario have abolished the requirement that these contracts be in writing.
7. Under sale of goods legislation, agreements for the purchase and sale of goods (not services) having a value exceeding a minimum amount. The minimum varies from jurisdiction to jurisdiction but is in the \$30 to \$50 range. When several goods are purchased at once, the aggregate price is used to determine whether the legislation applies. The requirement of writing is waived where the value of the goods is below the minimum, and also where (a) the buyer actually receives the goods and either makes a statement or commits an act that signifies the buyer's acceptance of the existence of the oral contract; or (b) the buyer gives part or full payment (by money or in kind) to the seller for the goods, and the seller accepts it. In both cases, the conduct of the parties establishes the existence of the oral contract and renders it enforceable as to the balance of its terms, including payment. Where the contract is for both goods and services, the requirement of writing under the sale of goods legislation does not apply.
8. Under consumer protection legislation, agreements that provide that delivery of the goods and/or services, or payment for them, is to occur at a future time. Typically, such legislation protects only the buyer, not the seller, and is designed to reduce the problems surrounding high-pressure sales tactics where the goods and/or services are not delivered at the moment of sale.

Part Performance

In the case of interests in land, the courts have softened some aspects of the rule that the agreement must be in writing. If pursuant to an oral contract to acquire land the plaintiff takes possession of and makes improvements to the land with the acquiescence of the owner such that it would be an injustice to the plaintiff if the owner were not held to the oral contract, the courts may enforce the contract if the part performance by the plaintiff is unequivocal evidence of the existence of the contract. If the performance is equally or more applicable to a different transaction, such as a contract to maintain the property, then the plaintiff's claim will fail.

The Privity Rule

Generally, the obligations and benefits arising under a contract are confined to the parties to the contract. Persons who are not parties to the contract are called nonparties, strangers or, sometimes confusingly, third parties. Under the common law rule of privity, a contract does not impose any obligation nor confer any benefit upon a nonparty. A plaintiff suing under a contract must prove privity (i.e., that he and the defendant are the parties to the contract being sued upon). If Bill contracts with a travel agency to buy Ann a plane ticket to Athens, Ann has no privity with the travel agency and cannot sue the agency if it breaches the contract. Only Bill has **privity of contract** on which to base a lawsuit.

Exceptions to the Privity Rule

In the case of *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108, the Supreme Court of Canada held that the doctrine of privity should evolve in light of modern commercial reality and be relaxed where:

- a) the parties to the contract intended to extend the benefit to the nonparty seeking to rely on the contract; and
- b) the activities performed by the nonparty must be the very activities contemplated as coming within the scope of the contract.

It remains to be seen how far this case will extend. In the meantime, to mitigate the often harsh consequences of the privity rule, the law recognizes ten exceptions where enforceable rights and liabilities may be enjoyed or suffered by non- or substituted parties. Set forth below are the ten exceptions. The first eight arise in hospitality law. The last two are included for completeness.

The Tort Law Bypass

As we shall see in Chapter 4, under the law of negligence (also known as tort law), persons who are not privy to a contract may recover damages for the injurious consequences of a contract by suing in negligence instead of suing in contract. For example, if a hotel caters a reception contracted for by a host, and a guest of the host suffers food poisoning, the stricken guest cannot sue the hotel in contract because there is no privity between the guest and the hotel. However, the guest can bypass that roadblock by suing in negligence.

Principals of Agents

As we shall see in Chapter 15, where an agent makes a contract on behalf of a principal, the principal becomes entitled to the benefits and subject to the obligations under the contract.

Vicarious Liability

Employers are vicariously liable when their employees harm a third party with whom the employer has no contract. Vicarious liability also arises under tort law. An employer may escape liability if the employee acted wholly outside the scope of his or her employment.

Corporation Formed by an Amalgamation

Where two or more corporations amalgamate, the new corporation is bound by any contracts previously entered into by any of the amalgamating corporations.

Collateral Warranties

If a contract features a collateral warranty provided by a stranger to the contract, an injured party to the main contract may sue the collateral warrantor. For example, a store may sell an oven to a restaurant with a manufacturer's warranty. If the restaurant suffers damage from a defective oven, the restaurant may sue the manufacturer directly. Collateral warranty is the contract law side of the coin; negligent misrepresentation (see Chapter 4) is the tort law side.

Assignment of Liabilities (Novation)

A promissor may assign his liabilities under a contract to another party, if the promisee consents. If promissors could assign liabilities without the consent, no one would ever have to repay a debt because a promissor could simply assign the liability to a deadbeat. (Assignment of liabilities is sometimes called "novation," but that term should be limited to when two parties tear up their first contract and enter into a new one. Novation is not really an exception to the privity rule; it is a new contract.)

Interests in Land

An assignment of liabilities may occur without the promisee's consent where the subject matter of the contract involves an interest in land (mainly mortgages and leases). Because the land secures the debt, the lender (mortgagee) is unaffected by the assignment and may sue both the original debtor (mortgagor) and the new one if the mortgage goes into default. Similarly, a subtenant under a sublease is subject to the terms of the original lease, and the landlord may pursue both the original tenant and the subtenant in the event of default.

Assignment of Rights

Generally, a party may assign her rights (as distinct from liabilities) under a contract. For example, a lender is free to assign to anyone her right to receive repayment of the loan. The assignee enjoys the same rights and is subject to the same obligations as the assignor.

Trusts

The settlor creates the trust, the trustee manages the trust, and the beneficiary benefits from the trust. The trust contract is between just the settlor and the trustee, but the interests of the beneficiary are so great that the law allows the beneficiary to enforce the terms of the trust.

Life Insurance Policies

A beneficiary named in a life insurance policy between an insured and an insurer may force the insurer to pay the insurance proceeds to the beneficiary upon the death of the insured.

Allocation of Risk

Generally, risk under a contract follows ownership or title to the subject matter. The parties are free to re-allocate responsibility for the risk. Hotels and restaurants often order supplies. The parties may determine whether the buyer or the seller shall bear the risk during transit. For cash-on-delivery (COD) contracts, the seller retains title and the risk until the goods are delivered to and paid for by the buyer. For free-on-board (FOB) contracts, the buyer acquires title to the goods and assumes the risk the moment the seller delivers the goods to the carrier. For cost-insurance-freight (CIF) contracts, the buyer acquires title to the goods before delivery, but the seller is responsible for the costs and risks of delivery to the buyer's location.

If there is no COD, FOB, CIF, or similar contract, title and risk may be determined by a bill of lading. A bill of lading is a receipt given to the seller by the carrier who is handling the consignment. The consignor on the bill is the seller. The consignee has the right to determine the delivery. If the buyer is the consignee, the seller loses control over the goods and the risk passes to the buyer. If the seller is the consignee, the seller retains control over the goods and bears the risk until delivery to the destination that the seller has designated on the bill.

E-Commerce Considerations

The traditional precepts of contract law continue to apply to electronic commerce. For example, Web-based advertisements are regarded as invitations to treat, not offers. However, an advertisement containing the number of units in stock could be considered an offer.

The *Uniform Electronic Commerce Act* allows acceptance to be made electronically. Acceptance occurs as with other forms of instantaneous communication at the place of acceptance unless the parties agree otherwise. As the globe shrinks and business is conducted in countries around the world, the place of contract acceptance can be important and problematic. A Canadian accepting an offer in Quebec City will normally enjoy the application of Quebec and Canadian law, as applicable, to the contract. A contract featuring parties in multiple countries poses interesting questions of applicable law especially if the rules of contract acceptance are different. Some countries do not follow our Western legal traditions.

In 1996, the United Nations adopted the Model Law on Electronic Commerce drafted by the United Nations Commission on International Trade Law. Its utility will depend on how many nations adopt it. Until there is international consensus, countries must enter into a series of bilateral trading partner agreements.

In Canada, the Uniform Conference of Canada has adopted the *Uniform Electronic Commerce Act*, which is based on the Model Law established by the United Nations. The *Uniform Electronic Commerce Act* is intended to harmonize federal and provincial legislation. The UECA has three parts to it.

Part 1. Provision and Retention of Information.

Part 1 gives legal recognition to electronic contracts, sets the conditions to meet requirements of the *Uniform Electronic Commerce Act*, the requirements for information to be in writing, recognition of electronic signatures, and the requirement to present and retain a document in original form.

Part 2. Communication of Electronic Documents

Part 2 provides that all matters of a contract can be expressed by means of an electronic document, permits the involvement of electronic agents, and establishes the time and place of sending and receiving of electronic documents.

Part 3. Carriage of Goods

Part 3 applies to actions related to contracts of carriage of goods.

All provinces and territories have enacted legislation for electronic commerce. In 2000, Ontario became the first province to enact e-commerce legislation—the *Electronic Commerce Act*, S.O. 2000, c.17. Among other things, it provides, with some exceptions, for legal recognition of electronic information and documents. It provides that electronic information or forms cannot be used, provided, or accepted without a person’s consent; however, consent may be implied by conduct except for public bodies, which are not bound unless they give their express consent. Information in electronic form is deemed to be in writing if it is accessible for subsequent reference and capable of being retained by the accessing person. Mere access, such as to a website, is insufficient. There must also usually be reliable assurance as to the integrity of the information in the electronic format. A legal requirement for a signature is satisfied by the provision of a prescribed, reliable electronic signature—typically an encrypted password. Electronic information is presumed to have been received by the addressee,

- a) if the addressee has designated or uses an information system for receiving information of the type sent, when it enters that information system and becomes capable of being retrieved and processed by the addressee; or
- b) if the addressee has not designated or does not use an information system for receiving information of the type sent, when the addressee becomes aware of the information in the addressee’s information system and it becomes capable of being retrieved and processed by the addressee.

Regardless of the physical location of the addressee’s information retrieval system, the electronic information is deemed to have been received at the addressee’s place of business. If the addressee has more than one place of business, the receipt is deemed to occur at the place of business having the closest relationship to the underlying transaction or, if there is no underlying transaction, the addressee’s principal place of business or, if there is no principal place of business, the addressee’s habitual residence. The Act does not apply to wills, codicils, testamentary trusts, powers of attorney, documents that create or transfer interests in land and require registration to be effective against third parties, negotiable instruments (such as bills of exchange), and, except for contracts for carriage of goods, title documents.

Void and Voidable Contracts

A contract that is defective or that has been breached may be void or voidable. If the contract is void, it has no legal effect. Judges are reluctant to find that a contract is void, and generally only do so if it is for an illegal purpose or if one or more of the six essential elements of a contract are missing. If the contract is void, the parties are returned to their pre-contract positions. If it is determined that the contract was for an illegal purpose, the courts will not return the parties to their pre-contract positions, and the losses will fall where they may.

A contract that is voidable is a contract in which the offending party has done something that allows the innocent party the option to rescind the contract or insist on performance. The innocent party may lose the option to rescind if:

1. he or she affirms the contract;
2. he or she takes some benefit under the contract;
3. he or she fails to rescind the contract within a reasonable time such that the position of the other party is adversely affected by the delay; or
4. an innocent third party acquires some rights under the contract prior to the attempt to rescind.

If the subject matter of the contract has passed to an innocent third party who has supplied value in exchange for the subject matter, the original owner may recover the subject matter only if the contract is void *ab initio* and was not for an illegal purpose. If the contract is merely voidable, the subsequent bona fide purchaser for value will be entitled to keep the subject matter, and the original owner may pursue only the person with whom the voidable contract was made, even if that person cannot be found or is **judgment-proof**. While void contracts may still be honoured by a party who feels a moral obligation to do so, the honouring is not pursuant to contract, but is merely a gratuitous charitable gesture or good deed.

Interpretation of Contracts

Rules of Interpretation

Once the contract has been formed, it must be interpreted. Most disputes revolve around not whether the contract exists but what the terms mean. Language being what it is, it is not unusual for reasonable people to disagree about the meaning of a contract, a term in the contract, or even the implications of the placement of a comma in a sentence. The devils, as is sometimes said, are in the details. While many contractual terms are expressly set forth in the contract, others are implied. Implied terms are commonsense matters arising out of the nature of the enterprise or transaction, or matters that would likely have been made explicit if the parties had thought of them in time to add them. As a rule, courts will imply reasonable terms to give effect to the intentions of the parties, but will not go so far as to draft a new contract.

Interpreting contracts is often difficult due to bad drafting, bad grammar, or misuse of vocabulary. The courts use two approaches to contract interpretation: strict and liberal. The strict approach concerns itself with the plain or dictionary meanings of the words and holds the parties to an objective reading of the contract. The more subjective liberal approach assesses the overall purpose of the contract and intention of the parties. The judges generally use whatever approach best allows them to do justice in the case. The rules of evidence apply, sometimes in combination with the *contra proferentum* and parol evidence rules (see below).

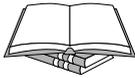
The *Contra Proferentum* Rule

A contract that has been drafted by one party and foisted on the other party, who therefore lacks a real opportunity to negotiate, will be interpreted strictly against the drafting party. Thus, the courts will interpret a standard form contract such as an insurance policy or airline ticket in favour of the consumer with respect to any loopholes or ambiguities in the wording.

The Parol Evidence Rule

Before a contract is entered into, the parties negotiate the terms orally or in writing. Many written contracts have a clause which states that the contract constitutes the entire agreement between the parties and that there are no terms outside the contract. If after entering into a written contract a party finds that a term is missing, he or she will be held to the contract as written. Where the other party does not consent to an amendment, the parol (“outside”) evidence rule prevents a term, previously agreed upon but not included in the final version, from being added to the written contract. Nothing stops the parties from making a contract that is partly written and partly oral; however, once the written part is executed, the **parol evidence rule** prevents one party from altering it without the consent of the other party. To the extent the terms are ascertainable, the oral part of the hybrid contract will continue to apply to the parties.

The parol evidence rule has many exceptions. It does not apply to evidence concerning the formation of the contract (e.g., legality, capacity, duress, mistake), or to evidence concerning any conditions precedent to the formation of the written contract. The rule does not apply to oral contracts made after the written contract. Extrinsic evidence as to the later oral contract, even concerning how the oral contract amended the written contract, is admissible.



H. v. K. (July 15, 1996, Doc. No. C954322, Vancouver, Lowry J. (B.C.))

H operated a business that consisted of a small eight-seat café in leased premises in an old building. In 1992, she approached the city for a licence to increase the café to 25 seats. The city gave her a temporary licence conditional on her remaining the occupant of the premises. H wrote the city confirming that she would abide by the requirement and would neither advertise nor sell the business as a 25-seat operation. Naturally, in a selfless gesture to give students a case to consider, she did otherwise. In 1994, she listed the business for sale as a 25-seat restaurant. K and S offered to buy the business assuming that it was licensed for 25 seats. The offer was accepted along with a deposit. The balance of the price was to be paid on closing. K and S began operating the business pending the closing. When K applied for a transfer of the licence from H to K and S, the city informed K that no licence would be issued for a 25-seat restaurant. H, K, and S then agreed to add the following **addendum** to the agreement:

Completion date is extended to 96 hours after the vendor has received a business licence approval for a 25-seat restaurant. In the event that approval for 25 seats is not received prior to June 30, 1995, then, at the purchaser's option, all deposit monies will be returned and the contract shall be null and void.

H contacted the city's Planning Department, which inspected the property. The Department made numerous recommendations for upgrades to the premises, which were financially impractical given the age of the building. As a result, H made no application for a 25-seat licence. She did receive a written confirmation that she could continue to use the space as a restaurant as long as there were no further alterations and she remained the operator. K and S closed the business and left the premises. H resumed possession and reopened the restaurant. Several months after June 30, 1995, she obtained the licence approval that K and S had requested. H then took the position that she had met the requirements under the addendum and claimed that K and S had orally agreed to extend the deadline.

H sued for damages, and K and S countersued for their deposit. The issue was whether H had received the approval for the licence change in accordance with the terms of the contract and its addendum. The court held that H had not received the licence for a 25-seat restaurant by June 30, 1995, and that the parol evidence rule precluded the inclusion of an oral term extending the deadline. H was ordered to return the deposit and pay K and S's legal costs.

Certainty of Terms

The essential terms of a contract must be precise enough to allow for a sensible interpretation. In some instances, custom and trade usage will make a seemingly vague agreement precise. For example, a contract for the purchase of nitrogenized marl may

be incomprehensible to a layperson, but very clear to a person in the agriculture industry. The essential terms must also be complete and not subject to uncertainties. Terms may be complete even though they are conditional provided the condition is capable of certainty. For example, a condition as to time should specify a date and not simply refer to “within a reasonable time.” Consideration is an essential term but it may be conditional on a future certain event. For example, the interest to be charged from time to time for default under a contract may be expressed as the prime rate of the Bank of Canada plus 3 percent. At the time of signing the contract, no one knows what the effective rate will be, but it is certain to be known at the necessary time.

Warranties and Conditions

Regrettably, the words “warranty” and “condition” are often used interchangeably and inconsistently. The word “warranty” should be used only to describe any term in a contract the breach of which gives rise to various remedies but none so drastic as the termination of the contract. The word “condition” should be used only to describe any term the breach of which is so serious and fundamental that the remedies include termination of the contract.

Waivers and Disclaimers

A party may waive his or her rights under a contract, but the language used must be clear. A waiver is effective only as to the terms waived. A party cannot impose a waiver on another party. The waiver must be the voluntary act of the waiving party.

Parties often attempt to minimize or eliminate some aspects of their contractual liability through the use of disclaimers. Here are two examples:

In the event of fire, theft, flood, lightning, war, destruction, strike, lockout, sabotage, plague, famine, pestilence, or act of God, Bombs Away Inc. disclaims all responsibility for any losses whatsoever howsoever, wheresoever and whensoever occasioned.

We express no opinion as to the accuracy of the information contained in this book.

Disclaimers are interpreted strictly against the party relying on them (*contra proferentum*). The more blanket the disclaimer, the less likely it will stand; the more limited the disclaimer, the more likely it will stand. The courts also look for fairness on the part of the person attempting to benefit from the disclaimer. If there was no reasonable opportunity to examine the terms or if they were not brought to the attention of the injured party, the disclaimer will be of little or no assistance to the party relying on it. Further, a disclaimer will generally not assist a party who is in fundamental breach of the contract because it would be unfair to allow a party to a contract to blithely breach the contract in outrageous ways and then rely on the disclaimer to avoid responsibility. (See also Chapter 4.)

Standard Form Contracts

Many businesses make use of standard form contracts. Examples include automobile leasing or sales agreements, insurance policies, and travel and event tickets. Standard form contracts are a convenience, but they remove any real opportunity to negotiate the terms. The offeree must take it or leave it. If he signs it, the courts will generally deem him to have read it and bind him to the terms. If he later wishes to bring a breach-of-contract suit, the courts will apply the usual rules of contract interpretation and liability. In the case of standard form contracts that are not signed, such as travel or event tickets and parking or cloakroom receipts, the courts examine additional matters. A promisor benefiting from an unsigned standard form contract must act reasonably and must bring

the essential terms of the contract to the attention of the promisee. The promisee will not be bound if the print was too fine to be legible, or if the risks were not brought sensibly to the notice of the promisee. Two examples of such notices are the signs in cloakrooms stating that “The management is not responsible for lost or damaged items,” and general posted warnings stating “Use at your own risk.”

The Importance of Good Grammar

Proper vocabulary and good grammar are critical to drafting and interpreting contracts. While it is never too late to acquire vocabulary and learn good grammar, vigilance and alertness are required. There is no one perfect code of grammar. There are many issues about which reasonable grammarians disagree, such as splitting infinitives and ending sentences with prepositions. Grammatical rules change over time, although not nearly as much as vocabulary, whether through the coining of new words (e.g., “hypermedia”) or through changes in meaning.

If there is no perfect grammar code, how can one ever be sure that one’s writings and utterances are acceptable? Those who say that the most important thing is to be understood are partly right. Those who insist that strict rules of grammar must be followed are also partly right. The fact is that clarity of expression is most easily accomplished by applying sensible rules of grammar and by using appropriate vocabulary. Proper punctuation is also important. For example, the insertion of commas can radically change the meaning of the same sentence. There is a world of difference between “Woman without her man is nothing” and “Woman, without her, man is nothing.” Mastering the basic rules of grammar is not difficult, and is worth the effort. Good grammar makes our communications more intelligible and our arguments more persuasive—“bad grammar do opposite.”

Termination of Contracts

So far, we have reviewed the six essential elements of contract formation and other matters such as enforcement and interpretation. Now, we turn our attention to how contracts may be discharged, impeached, breached, and remedied.

Discharge of Contracts

To discharge a contract is “to cancel or unloose the obligations of a contract” (*Black’s Law Dictionary*, 4th edition). Contracts are discharged in four ways.

By Performance

Discharge occurs when the parties to the contract have completed their respective parts of the bargain—that is, the performance expected of them.

By Agreement

If both parties have not yet finished their contractually required performances, they may agree not to complete the contract. The promise by each party not to insist on performance by the other is the consideration for the agreement not to complete. If one party has completed his or her performance and one has not, the discharge by agreement must be under seal unless there is fresh consideration.

By Frustration

A contract is frustrated when, through no fault of the performing party, a supervening event renders the contract impossible to perform. A contract to book three floors of the Tinderbox Lodge for a convention will be frustrated if the lodge burns down prior

to the start of the convention. The contract will not be frustrated if the promisor himself burns the lodge down as a means of escaping the booking. Self-induced frustration is breach of contract because of the presence of fault. Where the contract has been partly performed but then frustrated, the parties may be held to an accounting. Where the goods are obtainable elsewhere on the market, the loss of the goods will not necessarily frustrate the contract. If a restaurant orders 30 tablecloths, the supplier cannot plead frustration if the delivery truck is stolen because he can easily supply 30 more tablecloths. A party may contract out of the defence of frustration and remain liable despite an incident of frustration. Commercial leases, for example, may provide that the rent will continue even if the premises are destroyed. This forces the tenant to have insurance and protects the landlord against an interruption of revenue.

By Operation of Law

A bankrupt is absolved from liability upon an order for discharge. An undischarged bankrupt remains liable, through the trustee, for the realizable portion of his or her debts. A deceased is discharged on death from the performance of personal service contracts. Upon attaining majority, a minor is discharged from an unratified noncontinuing contract. Limitation Acts are statutes that limit the time within which a plaintiff may commence an action. They do not discharge contracts, but bar enforcement actions if the plaintiff fails to issue the claim prior to the end of the limitation period. If that happens, the defendant is for all practical purposes discharged from the contractual obligations.

Impeachment of Contracts

Contracts may be impeached by the victim of offending behaviour. The victim has recourse to many remedies, discussed in detail below, depending on the nature of the offending behaviour.

Duress

A party who is coerced into an agreement may, at his option, declare the contract void or insist on its performance. Duress includes extortion or the threat of extortion and violence or the threat of violence to the victim or the victim's parent, spouse, or child. It also occurs where the offender takes wrongful or deceitful advantage of the victim by, for example, refusing to honour the contract unless the victim sweetens the terms beyond the original contract.

Undue Influence

A party who is unduly influenced into entering into a contract may, at her option (exercised promptly once the undue influence has ended), either declare the contract void or insist on its performance. Undue influence most commonly arises when there is a special relationship between the influencer and the influencee in which the influencer has a special power or knowledge over the influencee. (Where an influencer exerts undue influence on an influencee, the influencee may catch influenza.) Examples of such relationships include lawyer/client, doctor/patient, and trustee/beneficiary. To remove any taint of undue influence, the dominant party should insist that the other party receive independent legal advice.

Mistake

Parties to a contract sometimes find that they have made a mistake, such that the contract differs in some respect from what they intended. The courts restrict the meaning of the word "mistake" in contract law. The lay definition of "mistake" would effectively

negate the usefulness of contracts as a business tool because there would never be certainty or reliability. The law recognizes three types of mistake: common, mutual, and unilateral.

A common mistake occurs when there is no disagreement between the parties about the nature of the mistake. For example, if a travel agent books a room in a hotel that both the agent and the customer believe is open but that is in fact out of business, the contract is void, and the parties are returned to their original positions.

A mutual mistake occurs when, unbeknownst to each other, the two parties have a different understanding of what a term means. The courts will not void the contract, but will rule on which of the two understandings is more reasonable. Suppose a travel agent thought that the booking was for the airport Hilton and the customer thought that it was for the downtown Hilton. If the airport Hilton is closed, the court may suppose that a reservation at a Hilton in the destination city was to be booked and therefore uphold the contract.

A unilateral mistake occurs when one party is mistaken about a term in the contract and the other party is aware of the misunderstanding. The contract is enforceable, and the party who is aware of the other's mistake is under no obligation to make the mistaken party aware of his or her mistake. On the other hand, if a party brought about the mistake by misrepresenting, however innocently, a fact that induced the other party to enter into the contract, then it is incumbent upon the former to inform the latter upon learning of the mistake.

Misrepresentation

There are three kinds of misrepresentation: innocent, negligent, and fraudulent. If the misrepresentation was innocent, the plaintiff can sue for **rescission** but not for damages. If the misrepresentation was made recklessly or carelessly, it is negligent; if made knowingly, it is fraudulent. Upon proving negligent or fraudulent misrepresentation, the plaintiff may terminate the contract and sue in contract and tort for damages. In all cases of misrepresentation, the victim may insist on performance by the offender rather than rescission or damages. (In tort law, there are only two kinds of misrepresentation: negligent and fraudulent, also known as **deceit**.)

Under common law, a misrepresentation of mere opinion is insufficient to found an action in contract; it must be a misrepresentation of a fact. The inflated statements of sellers regarding their products—"This is the best car you can buy" and "My motel is worth at least \$200,000"—are not misrepresentations of fact and thus are not actionable under common law. However, statements such as "This car has only 27 000 kilometres on it" when the car has 127 000 kilometres on it, and "I have an offer for \$190,000" when no such offer has been made, are misrepresentations of fact and actionable as such. The statement "My motel is worth at least \$200,000" is not a misrepresentation of fact because the price is dependent on what a given buyer will pay. There are no ceilings on price, only floors. In this regard, it is wise to remember that price and value are very different concepts.

It is not always easy to determine whether a statement is fact or opinion. Legislation prohibiting unfair business or trade practices has extended the common law remedies of rescission or damages in certain circumstances to cover losses resulting from inaccurate or dishonoured statements of mixed fact and opinion or in situations in which it is difficult to determine whether the statement is fact or opinion.

Many cases of misrepresentation in the hospitality industry deal with misleading financial and other information in the purchase of the business, including misrepresentation as to government permits and licences, the condition of the physical plant, the potability of the water, the historical profitability of the business, and an endless list of other conditions of sale.

B. v. 7 Ont. Ltd. (January 20, 1995, Doc. No. 27421/91, E. MacDonald J. (Ont. Gen. Div.))

The vendor of a restaurant had his accountant prepare a second set of books that gave an enhanced aroma to the economic feasibility of the restaurant. A purchaser, seduced by the succulence of the cooked books, bought the business. He later obtained the correct information and proved that the books were nothing more than a soufflé of deceit. The court found the vendor guilty of fraudulent misrepresentation and awarded the plaintiff \$340,000 in general damages and \$20,000 in punitive damages.



Contracts of Utmost Good Faith

Sometimes information critical to the contract is known by only one of the parties. If the contract requires a high level of trust between the parties, the knowledgeable party must disclose the information to the other party. For example, a hotelier must disclose to an insurer whether or not the hotel has suffered a previous fire and the location of the nearest fire hydrant. If the utmost good faith is not demonstrated by the hotelier, the insurer need not honour the insurance policy. This doctrine, indiscriminately applied, would render commercial relationships quite uncertain. The mere withholding of special knowledge is not enough to invoke an impeachment remedy; the withholding must occur within a contract that the courts have imbued with a duty of utmost good faith.

Non Est Factum

Generally, the courts will bind a person to her bargain on the assumption that she read and understood the contract before signing it. If she can satisfy the court that the contract she signed was qualitatively different from the contract she thought she was signing, then the document may be set aside on the basis of *non est factum* ("It is not my deed"). This defence was more common when more people were illiterate. Today, this defence rarely succeeds.

Breach of Contract

A party is usually considered to have met his or her obligations under a contract if the obligations have been substantially performed. What constitutes substantial performance depends on the contract and the circumstances surrounding the performance. Generally, if the contract has been substantially performed, then it has not been breached. Thus, a minor breach will not normally free the parties to a contract from performance. The breach must be of the whole contract or a fundamental condition. A contract is breached when repudiation, failure to perform, or sabotage occurs.

Repudiation

A party may declare that he will not commence or complete the performance required by the contract and thereby repudiate the contract. If the repudiation occurs before the time for commencement of the performance, the innocent party may anticipate the breach, rearrange her affairs accordingly, and sue for any damages.

Failure to Perform

One party may fail to perform fully as required in the contract. There is no express repudiation, but the performance is less than contracted for. There are degrees of failure to perform, ranging from partial to complete. The remedy may take into account any partial performance.



Karalekas v. Canada Trustco (unreported, 1998), Ottawa Small Claims Court

In 1997, a Canada Trust branch made a reservation at the Steak and Caesar Restaurant in Ottawa for 30 people for the Saturday before Christmas. In effect, the bank promised to send 30 paying diners and the restaurant promised to feed them. No one called to cancel and no one showed up. Unable to obtain an explanation or an apology, the restaurateur, Paul Karalekas, sued the bank for breach of contract in Small Claims Court and won. The court found that a bilateral contract had been brought into being by virtue of the exchanged promises and awarded the restaurant \$1,765.

Not every broken dinner reservation will result in damages for breach of contract. As we will see below, a plaintiff must demonstrate damages and that may be difficult if a couple breaks their reservation but the restaurant nevertheless does good business that day. Here, a large part of the restaurant had been set aside for the large number of diners expected and it was not available for other patrons until it was too late.

Sabotage

One party may perform a willful act that is in contradiction to the agreement or that renders the contract incapable of being performed. In the case of a magician contracted to appear at a resort, a willful act can be anything from releasing the rabbits into the wild to refusing to pay for the transportation necessary to reach the resort.

Remedies

Breach of contract does not necessarily mean that the contract is terminated. The innocent party may forgive the breach and continue to regard the contract as legally binding. If the innocent party terminates the contract, however, various remedies become available.

Limitation Periods

An aggrieved party must commence the action before the end of the statutory limitation period; otherwise, the claim is barred. Limitation periods across Canada range from six to 20 years.

Necessity of Loss

Under contract law and civil law generally, except where nominal or **punitive damages** are claimed and assessed, one cannot successfully sue unless one can demonstrate a loss.

Duty to Mitigate

Under contract law and civil law generally, an injured party has a responsibility to **mitigate** or contain the damages as much as is reasonably possible. For example, although statutes now provide minimum severances for many employees, under common law a person who has been wrongfully dismissed must honestly look for a new job in order to minimize the damages claimed above the statutory minimum. The plaintiff may not take advantage of the situation by running up unnecessary expenses, thereby inflating the claim.

W.E.M.L. v. M.R.C.L. (December 4, 1995, Alta. C.A.)

P signed a long-term lease for a restaurant in a mall. The space was L-shaped and had little frontage. The venture was unprofitable. P closed the restaurant and moved his inventory out. P continued to pay rent, but ultimately the landlord served a termination notice. Although the lease terminated, P remained liable for the rent under a liquidated-damages clause in the lease. Eventually, P stopped paying the rent. In doing so, he claimed that the landlord had not mitigated and thereby released him from his obligation to pay rent as damages. The landlord contended that he was unable to relet the property because of a slow market. P argued that the difficulty in reletting was a direct result of the shape of the shop: if the landlord allocated more frontage, the shop could be relet. The court ruled that while there had been no failure to mitigate up to the time of the trial, there had been a failure to mitigate continuing from the time of the trial. The landlord was ordered to repay the rent (with interest) from that point forward.



Rectification

In some circumstances, the courts will rectify a written contract that contains a clear error for which there is ample evidence. The most common are typographical errors and mistakes in copying information from source documents. The party asserting the error must convince the court that it is necessary to correct the error in order to give effect to the clear intentions of the parties. The courts will not rectify the contract if to do so would in essence rewrite the contract for the parties. The remedy is available only to correct a written document so that it corresponds to the intention of the parties. Rectification cases rarely reach a courtroom. Most often when there is such an error, the parties execute an amendment to the original contract to correct the error. A claim for rectification may require a judge's intervention if one of the parties has taken an assignment of the contract and is unsure whether a mistake occurred.

Rescission

If the parties can be returned to their pre-contract state, an innocent party may opt to rescind the contract instead of continuing to enforce it. In that event, the innocent party cannot seek damages: the party has been returned to his or her original state and therefore has suffered no damages.

Injunctions

An innocent party may wish to restrain an offender from acting inconsistently with the contract. For example, if a diner has an exclusive contract with a supplier for papayas, the diner may **enjoin** the supplier from supplying the papayas to a competitor for the duration of the contract. Interim injunctions may be obtained until the matter can be dealt with more completely by the courts. If the subject matter of the contract is perishable or susceptible to swift disappearance such that awaiting trial would render the dispute moot, an applicant may obtain a preservation order, which preserves the subject matter until the dispute can be dealt with more fully.

Specific Performance

In some cases, the innocent party wishes to have the original benefit of the contract, not a monetary compensation. An award of damages may be inadequate compensation if

the subject matter of the breached contract is rare or unique, such as land or art. In such cases, the innocent party may seek a court order that requires the breacher to perform the contract as originally contemplated. Courts will not order specific performance if supervision of the performance by the court would be required. For example, a travel guide will not be ordered to act as a guide if he or she refuses to honour a contract.

Quantum Meruit

Some contracts, particularly oral ones, make no mention of the price to be paid for the provision of the goods or services. Applying the principle of *quantum meruit* (“the amount he merits”), the courts may award the reasonable worth of the goods delivered or services rendered. A person cannot merit an amount by unilaterally supplying a good or service, or we would all be fabulously wealthy (at least until someone turned the tables on us). The provision of the goods or services must come at the request of the person who is to be liable to pay the merited amount. The doctrine of *quantum meruit*, which concerns goods and services, is first cousin to the doctrine of part performance, which concerns interests in real property.

Damages

Damage awards are intended to put innocent parties in the position they would have been in if the contract had been completed. This is accomplished by providing fair compensation for the reasonably foreseeable losses resulting from the breach of contract. The compensation is for damages that were reasonably foreseeable at the time the contract was made, not at the time of the breach. Parties should be held liable only for matters that were within or ought to have been within their contemplation at the time they entered into the agreement.

Nominal Damages

Sometimes a party wishes redress on principle even though there are minimal or no losses. A court may award nominal damages of typically one dollar. However, to discourage the uneconomic pursuit of mere principles through the court system, judges may also chastise the winning party with an unfavourable award of legal costs.

Liquidated Damages

The parties may by contract predetermine the amount of the damages in the event of a breach. If the amount is a genuine pre-estimate, the courts will usually allow the **liquidated** damages to stand. If the amount is too high, the courts may strike it as a penalty. If it is too low, the courts may strike it as a disguised exemption clause. Courts tend to uphold exemption clauses if the breach is of a nonfundamental term, and to strike them if the breach is of a fundamental term.

Expenses and Loss of Profits

The innocent party may recover expenses and reasonably anticipated profits lost as a result of the breach if the expenses or loss of profits were contemplated by the parties at the time of making the contract. The innocent party may also recover losses that flow naturally from the breach even if they were not overtly in the contemplation of the parties, provided they were reasonably foreseeable had the parties turned their minds to the issue at the time.

General Damages

Some nonmonetary losses, such as mental distress, are difficult to quantify. Such losses are tort law concepts. A court must estimate the monetary compensation, known as general damages, for nonmonetary losses. Mental distress can occur when, for example, a holiday is ruined by a breach of contract, or when an employee is wrongfully dismissed.

Punitive and Exemplary Damages

Punitive and **exemplary damages** are awards above compensatory damages. Punitive damages are imposed to punish the offender for malicious or wanton behaviour such as an unconscionable breach of contract. Exemplary damages are imposed to make an example of the offender, not necessarily to punish, though the payor may find the distinction rather subtle.

B.C. Ltd. v. G. Holdings Ltd. (May 31, 1996, B.C.S.C., Doc. No. C930387, Melnick J., Vancouver)

When negotiating to buy a hotel, P had doubts about the financial statements but closed anyway. Pursuant to the contract, D was required, on closing, to deliver to P the assets required for the normal running of the business and to have maintained those assets until the closing. The building was also warranted to be in sound condition. After taking possession, P found that some of the equipment included in the agreement was missing and that the building was not in a state of good repair. P brought an action against the defendant for breach of contract, claiming that he had been fraudulently misled. Evidence at trial established that D had removed many items of inventory. Members of the hotel staff testified that, at the time the agreement was executed, the roof and boilers were in a poor state of repair and the roof had serious leaks. The court awarded P damages of approximately \$218,000 for breach of contract. In addition, the court found that D had made many fraudulent misrepresentations, and awarded a further \$198,400 as punitive damages. The punitive award might have been higher, but P was found to have been contributorily negligent in that he failed to take advantage of his opportunities to be more diligent in inspecting the statements, inventory, and premises.



This case demonstrates the need for a vendor to ensure that a purchaser is not misled, and the need for a purchaser to carry out all sensible pre-closing inspections and analyses. At a minimum, most purchasers should consult professionals with expertise in law, financial statements, and building inspections.

Enforcement of Remedies

Once the plaintiff has obtained a judgment or an order against the defendant, the defendant may comply without further ado. If not, the plaintiff may seek the assistance of the sheriff's office to seize and sell the defendant's assets or garnishee the defendant's wages. Failure by the defendant to abide by an injunction or order for specific performance may trigger contempt of court proceedings. As a practical matter, remedies are only as good as the credit of the defendant. Choose your debtors wisely.

Contracts in the Hospitality Industry

A myriad of the interactions between hospitality providers and the public are contractual, such as reserving a room at a hotel, ordering a meal at a restaurant, booking a holiday through a travel agent, hiring and firing staff, ordering supplies, buying or leasing equipment, buying or leasing premises, buying business and other insurance, entering into a franchise agreement, engaging renovators and repair technicians, and retaining professionals for advice.

Reservation Contracts

The room-reservation contract is central to the operation of a hotel. Everyday hotels handle hundreds of thousands of these contracts. Potential guests can make reservations by telephone or through the Internet. Many hotel chains have reservation centres that handle large numbers of reservations on a daily basis for all their properties and associates.

A room reservation is a contract between an innkeeper and a guest. To be enforceable, it must have the six essential elements of a contract. Failing to honour a reservation is a breach of contract. An innkeeper who dishonours a reservation may be liable for the guest's costs. A guest who does not cancel a reservation in the manner agreed upon in the reservation contract may be liable for the price of the room. Many hotels require that all guaranteed reservations must be cancelled prior to 6:00 p.m. A "no-show" is a reservation contract that has been breached by a guest. Unless the reservation has been guaranteed by the guest and the hotel has obtained a credit card number, no-shows are a largely uncollectable expense. The guest may have a plausible but unverifiable excuse, such as having cancelled the reservation through a staff member whose name is unknown.

Hotels should have a clear cancellation policy indicating the time by which a guest may cancel without penalty. Cancellation numbers or time and date codes given to the guest and recorded by the hotel can put the hotel in a strong position when pursuing a guest for breach of a reservation contract. Whether the hotel should do so, particularly when the guest is a long-time and valued client, is a business decision that calls for discretion and a sense of public relations. In the case of large bookings and resort and cruise ship reservations, the contract should indicate the deadline for cancellations without penalty, and set forth any partial payment and administrative charge policies. When reservations are cancelled on time, advance payments or deposits (minus allowable administration charges) should be returned without delay with a letter expressing the hope that the hotel may be of service in the future.

Guests may guarantee their reservations by forwarding a deposit or by providing a billing address, but usually do so by credit card number. A guaranteed reservation is advisable when a hotel is busy or when the guest is planning to arrive after 6:00 p.m. Some hotels confuse the issue by advertising that they guarantee all reservations. This may be nothing more than a promise that, as long as the guest arrives before the agreed-upon time, a room will be available. Hotels using such marketing ploys should word them carefully.

Overbooking

A hotel room is a most perishable commodity—if a room is not sold on a particular day, that room's revenue is lost forever. Experience shows that a percentage of guests with reservations will not arrive. In order to maximize revenues, innkeepers regularly overbook. Provided they do not overestimate the no-shows, no harm results. However, most hotels have at one time or another failed to honour room reservations.

A hotel should have a standard operating procedure to guide their staff's actions when overbooking and **walking the guests**. This policy should include a guideline as to how many extra reservations can be taken. In such a case, a manager should deal with the guest. The manager should acknowledge forthrightly that the hotel is holding the reservation, apologize for being unable to honour it, minimize the inconvenience to the guest by promptly arranging for a comparable room in another hotel and by covering the guest's reasonable expenses such as telephone calls, taxi fare to the new hotel, and any tips already given to the porter. If the guest must commute back and forth—as would be the case if the first hotel were hosting a convention attended by the guest—the additional expenses should also be covered. If such procedures are followed, then the walked guest will likely not incur damages and therefore have little grounds to seek legal retribution.

Some guests will be very understanding and, if well treated, may return to the first hotel. The airlines offer special incentives for people willing to offer up their seat. There may be some opportunity for hotels to look at such programs.

Appendix 3 contains a sample room Reservation Contract Reply Form. It provides evidence of the existence of a reservation contract by providing evidence of the offer, the acceptance, the consideration, and mutual intent of the two parties. Any concerns the reservations representative of the hotel may have concerning the capacity of the guest to enter into the reservation contract may be indicated in the "Remarks" section of the Reply Form; otherwise, capacity is assumed. Legality is also assumed. Note that assumptions may be rebutted when appropriate. Not all accommodation providers use a Reply Form to confirm a reservation contract, particularly with repeat guests. Instead, they rely on the reservation contract typically made over the phone or on the Internet and usually guaranteed by a credit card number.

Conventions and Business Meetings

Success in the convention, meeting, banquet, and catering field depends on the attention paid to the details of the guest's requests. These functions are planned far in advance. The planners of the event are often not present at the time of performance. Sales staff for the property will meet with the guest and draw up the contract for the event. It is imperative that the service staff is informed of all requirements.

Conventions usually involve large numbers of attendees and overnight accommodation. Business meetings may involve smaller numbers of people using meeting rooms but not overnight accommodation. Listed below are some of the issues that should be addressed in a convention or business meeting contract, as applicable:

1. Whether to offer a mass check-in option to the convention organizers. If the organizers or the hotel prefer to register each guest individually, the hotel should be in a position to do so quickly and efficiently.
2. Whether special equipment such as overhead projectors, flipcharts, movie screens, faxes, modem outlets, and secretarial services are to be supplied. If they are, the contract should specify the number, type, charges, time limits, and damage policies.
3. Whether the walls of the rooms or public areas may be used to post information or hang products and, if so, the responsibility for damage repair.
4. Whether signs can be erected and, if so, the size, type, and location of the signs, and the responsibility for their removal.
5. Whether coffee and meals are included and, if so, the quality and quantity, and the timing, charges, and clean-up responsibilities.
6. Whether public relations, media management, public access, privacy measures, and security services are to be provided and, if so, the nature and cost of them.
7. Responsibility for insurance coverage and the amount and types of coverage.
8. The number, type, location, and layout of meeting rooms reserved for the participants.
9. The number, type, and location of bedrooms the hotel reserved for the participants.
10. The number and type of any meals to be included (banquet/catering contract checklist).
11. Cancellation policies, guarantee dates, deposits, notice provisions, warranties, and other such administrative matters.

Successful special events, such as this banquet, are the result of careful and detailed planning.



Banquets and Catering

Banquets are held on-site at the hotel or restaurant. Catered functions are held off-site but make use of the establishment's where-withal. The staff may attend and prepare the meals off-site, or prepare the meals in-house and transport them to the site. Listed below are some of the issues that should be addressed in a banquet/catering contract, as applicable:

1. The names and addresses of all the parties to the agreement.
2. The dates when the minimum and final numbers of participants must be known.
3. The charge policies for additional participants and no-shows.
4. The date and time of the function.
5. The location of the function—on-site or off-site. If the site is in the client's home or place of business, whose kitchen facilities will be used and when will they be available?
6. The size and type of rooms. Many establishments offer different rooms for different purposes. A politician will be annoyed if she is given a room so large that it looks like she has little support. A groom will be annoyed if his relatives are exiled to the corridor.
7. Whether rooms adjacent to the function room are included. A host with an open bar is not interested in supplying drinks to the party next door. Brides and grooms often require change rooms. What is the cost and who shall pay?
8. Whether the lobby or other public areas may be used for picture-taking or displays. Double-booking of these areas should be avoided.
9. The floor plan for the tables and dance floor, and whether the dance area will be clear for the whole event or cleared after dinner.
10. The type (china, paper, plastic) of place settings (dishes, cutlery, and napery) required. If the site is in the client's home or place of business, whose settings will be used?
11. The style of service (buffet or served) for the meal and any hors d'œuvres.
12. The full menu including all charges, changes, extras, and substitutions.
13. Whether a late-evening snack before the end of the banquet is included.
14. Whether the bar service is open (prepaid by the host) or cash (paid by the participants), as well as the hours of service and the supply of bartenders.
15. The type and quantity of alcohol to be served.

16. Staffing, security, and any other services expected from the hotel relating to public relations and media/public access and control.
17. The supply and format of any entertainment, including any restrictions.
18. The number of nondining guests who may be joining the party before or after the meal.
19. Cancellation policies for both parties, including circumstances beyond the control of one or both parties (e.g., fire, accidents, labour strife, acts of God).
20. The advance-deposit policy.
21. The payment policy. Label tips and taxes as either included or extra.
22. The gratuity policy.
23. Repayment policies.
24. Amendment policies.
25. Disclaimers.
26. Responsibility for insurance and the amount and types of coverage.
27. Any other goods or services for the event, such as decorations and entertainment.
28. Any disturbances caused by setting up and taking down temporary buffets.

Establishments may cater in-house or they may hire outside caterers. All responsibilities should be clearly specified. Any changes should be revealed in a timely fashion. If the guests are expecting in-house catering and an outside service has been retained, it is necessary to advise them without delay. If a caterer is providing service to a location he does not own or control (e.g., a private home or a rented hall), it is imperative to address such issues as the supply of cutlery and linens, and the condition of the location, before and after the banquet.

Summary

Well-constructed contracts are essential to the smooth functioning of business relationships. The hospitality industry uses a myriad of contracts on a daily basis. Contracts should be carefully negotiated and reviewed by legal counsel to enhance their effectiveness, cover contingencies, and avoid unwanted consequences and problems of misinterpretation. Although many contracts are equally binding whether they are written or verbal, other contracts, such as agreements of purchase and sales of real estate, must be in writing to be enforceable. In law as in medicine, preventing a problem is far more cost-effective than treating it. Individuals should seek legal assistance before entering into any material agreement or relationship that has legal consequences. Appendix 3 has many sample hospitality contracts.

Discussion Questions

1. How does a unilateral contract differ from a bilateral contract? Give an example of each.
2. What is the difference between an invitation to treat and an offer? Give examples.
3. What are the six essential elements of a contract? Can a valid contract be formed in the absence of any one of the elements? Why or why not?
4. Draw up the standard operating procedure for walking a guest.
5. Analyze a business meeting or banquet contract to determine whether all the elements of contract formation are present, whether the language used is clear, and whether all parties have been well protected.

6. Under what circumstances can a minor be held responsible for using a hotel's facilities? Give examples of instances when a minor may not be liable.
7. Harvey, the owner of a small corporation, booked a business meeting room on behalf of the corporation. The room was at the Cliffhanger Lodge and the reservation was for the next weekend. The night before the meeting was to start, Harvey entered the hospital with chest pains. He cancelled the booking. It was too late for the lodge to accept another booking for the room. Is the lodge without recourse? Why or why not?
8. With legal advice, Claude, the new manager of a hotel and convention complex, signed an employment contract which provided that should he be terminated for any reason, he could not work for any hotel and convention complex in Canada until 10 years had elapsed. The hotel fell on hard times and dismissed Claude, paying him a reasonable severance. Claude moved to a new province and was immediately hired to manage a convention complex of comparable size to his previous employer. His previous employer went to court to prevent him from working for the new complex and to recover monetary damages. Assess the strengths and weaknesses of Claude's defence.
9. Protagoras (c. 490–421 B.C.), a Greek philosopher, posed the following conundrum: A law professor made a contract with a student, which provided that the professor would not be paid until the student had won his first case as a lawyer. At the end of the course of study, the professor demanded payment, but the student refused to pay on the basis that he had not yet won a case. The professor sued the student, believing that he could not lose. If he won the case, he would have an enforceable judgment against the student. If he lost, the student would have his first victory as a lawyer and would have to pay. As the trial began, the student moved for a nonsuit, believing that he could not lose. If he won the motion for the nonsuit, he would not have to pay his professor. If he lost the motion, he would not have won his first case and would still not have to pay. Who should win and why?