

THE CONTRACT FORMATION PROCESS

CONTRACT LAW: ESSENTIAL SKILLS FOR NON-LAWYERS

HYATT HOTEL CANBERRA

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THE PRESENTER

Sean King is a Director at Proximity, a leading provider of legal and procurement services to the government sector.

Sean is a highly regarded lawyer with significant experience acting for Australian Government clients. He has wide ranging commercial and contracting expertise including in respect of procurement, outsourcing, funding agreements, MOUs and licensing. Sean assists clients to achieve good procurement results through effective and efficient management of the procurement process from deal structuring to tender evaluation to negotiation support.

INTRODUCTION

A contract is an agreement between two or more people that is enforceable by the law. Contracts are a daily feature in commerce and play a central role in successful economies by allowing people to make and rely upon legally enforceable agreements. Contracts are entered into regularly by individuals, corporations and governments. In general, the ordinary law of contract applies to government contracts.

The law of contract is not entirely static. It is constantly evolving, although usually change occurs gradually without fundamentally altering the basic principles. As recently as 2012 the Australian Government sought submissions in relation to its Review of Australian Contract Law.

The law of contract is not consistent between countries (or even states). This presentation relates to the laws of contract that apply in Australia. Globalisation and international trade means that the chance of encountering contracts based on other legal frameworks is increasing. The laws of contract that apply in some of Australia's biggest trading partners (eg China and Japan) are significantly different to Australian law.

TOPICS

The topics that I will cover in this presentation are:

- › The basics of contract formation
- › The contract vs the pieces of paper
- › Practical review of some key terms
- › Types of agreements
- › Using templates
- › Breach of contract
- › Tips and traps

THE BASICS OF CONTRACT FORMATION

OFFER

- › Promise for a promise
- › Not a statement of intention (eg I will drive you to Sydney)
- › Not an invitation to treat (eg a tender)
- › Can be in writing, oral or implied
- › Can be made to an individual, a group or the world at large
- › Can have a specified period for which the offer remains open
- › Can be withdrawn any time before acceptance

Acceptance

- › Unconditional acceptance
- › Conditional acceptance results in a counter offer
- › Can be in writing, oral or implied
- › Examples - signing a document, agreeing over the phone, clicking 'I agree' on a web page or acting consistently with the contract (eg driving into a parking lot)

Consideration

- › Something of value – but does not have to be of equivalent value
- › Does not have to be money – could be a good, service or a counter promise
- › Peppercorn rent

Intention

- › Intention to create a legal relationship
- › Commercial dealings - assumption that intention exists
- › Private dealings - assumption that intention does not exist
- › During negotiations parties may use the phrase 'subject to contract'

Capacity

- › Must have capacity to enter a legal arrangement – eg an individual, incorporated association or company
- › Commonwealth is a legal entity (body politic established by the constitution) with capacity to enter contracts

Certainty

- › There must be certainty of the contract terms
- › Court will try to find certainty
- › Unilateral right to terminate a contract at will without compensation could make a contract void for uncertainty
- › Whitlock v Brew – void for uncertainty – requirement for Brew to lease the land to Shell on terms as commonly govern such a lease

Formalities

- › Particular formalities must be met for some forms of contracts.
- › For example, although in general a contract is not required to be in writing, a contract for the sale of land must (in most states and circumstances) be in writing and be signed

THE CONTRACT VS THE PIECES OF PAPER

Implied terms

- › Implied by the common law or by legislation
- › Specific contract (implied as a question of law) - terms implied to a specific contract must:
 - a. be reasonable
 - b. be necessary to make the contract effective
 - c. be so obvious that it goes without saying
 - d. be capable of clear expression
 - e. not contradict an express term
- › Class of contract (implied as a question of fact) – terms implied into a class of contract must
 - a. be suitable to be implied in all contracts in that class
 - b. be necessary
 - c. not contradict an express term
- › Custom
 - a. custom that is well known
 - b. people who make contracts of that type would assume the term applied
 - c. not contradict an express term

Variation

- › Court may find that the parties agreed to vary the contract
- › The contract will be varied even if the physical printed contract is not amended

Estoppel

- › The first party makes a representation
- › The other party relies on the representation to its detriment
- › It would be unconscionable to allow the first party to change its position
- › Example – a promise to exercise an option, or to not terminate for convenience

Waiver

- › Waiver by election
- › For example, a breach giving rise to a right to terminate
 - a. must elect to terminate or affirm
 - b. a failure to make an election may result in the right being waived
 - c. can reserve rights for a period of time

Controlled contract change

- › In a major project, change is almost a certainty
- › The change should be managed in a controlled way
- › Follow the variation procedure specified in the contract (eg CCPs)

PRACTICAL REVIEW OF SOME KEY TERMS

Risk sharing

- › Warranties, liability caps, indemnities, exclusions of consequential loss, insurance
- › Australian Government policy – the party that is best placed to manage the risk should bare the risk
- › Why not just transfer all risk to the contractor?

Liability cap

- › Limiting liability
- › Common exclusions from the liability cap – death, injury, breach of privacy or confidence, unlawful acts
- › Australian Government policy – A guide to limiting supplier liability in ICT contracts with Australian Government agencies
- › Risk assessment
- › Per event, or in aggregate

Indemnity

- › Risk transfer mechanism
- › For example, an indemnity for claims of intellectual property infringement
- › Commonwealth can and does give indemnities
- › Guidelines for Issuing and Managing Indemnities, Guarantees, Warrantees and Letters of Comfort
- › Creates a contingent liability

Consequential loss

- › *Environmental Systems Pty Ltd v Peerless Holdings (2008)*
Consequential loss is anything beyond the normal measure (loss that is specific to the injured party and that would not be suffered by other parties in a like situation)
- › *Regional Power Corporation v Pacific Hydro Group Two Pty Ltd (2013)*
Consequential loss should be determined according to its natural and ordinary meaning, read in the light of the contract as a whole

Liquidated damages

- › Liquidated damages, key performance indicators, performance measures, service rebates
- › Aim to avoid court, the difficulties of establishing damages and termination
- › Typically a percentage or a per day or per week amount
- › *State of Tasmania v Leighton Holdings (2005)*
 - a. contract for the construction of a road

- b. liquidated damages of \$8000 per day, equaling approximately \$2.5 million
- c. can consider loss of public good or utility in calculation liquidated damages
- › Must not be unconscionable

Entire agreement

- › Need to ensure all the promises in the tender are incorporated in the contract
- › Not effective to prevent estoppel

Intellectual property

- › Intangible rights that exist at law to protect creative endeavour
- › Copyright, patents, trademarks, circuit layouts, plant breeders rights
- › Intellectual property rights are separate from the physical property
- › For example, ownership of the book vs ownership of the IP rights that allow copying
- › Can be sold or licensed

TYPES OF AGREEMENTS

- › Contracts and agreements
- › Deeds
 - a. deeds do not require consideration
 - b. common examples include Panel Deeds, Third Party IP Deeds and Bank Guarantees
 - c. formalities – in writing, expressed to be a deed, signed and witnessed
- › Standing offers
 - a. legally binding promise to keep an offer open
- › Memoranda of understanding
 - a. Commonwealth is a single legal entity (body politic established by the constitution)
 - b. a party cannot enter into a contract with itself
 - c. not legally binding

USING TEMPLATES AND STANDARD FORM CONTRACTS

- › Only a starting point
- › Need to select the right template
- › Need to understand the contract and complete the schedules correctly
- › Some deals require a custom drafted contract
- › Glossary, structure and cross-references

UNFAIR CONTRACT TERMS

- › Australian Consumer Law – Competition and Consumer Act (replaced Trade Practices Act)
- › Consumer contracts - wholly or predominantly for personal, domestic or household use or consumption
- › A term of a consumer contract is unfair if:
 - a. it would cause a significant imbalance in the parties' rights and obligations arising under the contract
 - b. it is not reasonably necessary in order to protect the legitimate interests of the party who would be advantaged by the term
 - c. it would cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

BREACH OF CONTRACT

- › Damages
- › Specific performance
- › Injunction
- › Termination
- › Contractual remedies – for example liquidated damages

TIPS AND TRAPS

Privity of contract

- › A contract only binds the parties to the contract
- › If a third party gets a benefit under a contract, that third party is not entitled to sue for breach of contract if it does not receive the benefit

Contract management

- › Delay
- › Must make an election (eg affirm or terminate) within a reasonable time, can reserve rights
- › Relationship

Process contract

- › Requires compliance with the conditions of tender
- › Agencies often seek to expressly exclude a process contract

Termination

- › Termination for default – repudiation, follow process
- › Termination for convenience – doctrine of executive necessity, good faith
- › Always seek legal advice

Good faith

- › Express or implied
- › More likely to apply to government

- › Honestly, reasonably, no improper motive, with due respect for the bargain
- › No obligation to put the interests of the other party first
- › Does not prevent the exercise of rights that you have (example – the payment of supplementary fees)
- › Examples of bad faith
 - a. an insurer entering a contract of insurance for a ship's voyage, when the insurer privately knows that the ship has already arrived at port safely
 - b. the buyer in a contract that is 'subject to finance' not attempting to obtain finance

Agreements to agree

- › Not enforceable
- › Include a backstop or a resolution process

PROXIMITY

Proximity is leading provider of onsite legal and procurement services. Proximity provides clients with access to the highest quality advisors when and where they need them.

Proximity is highly regarded for its unique offering:

- › **One model** – we work onsite with you and your team; dedicated to achieving your objectives
- › **One sector** – the government sector is our sole focus; we understand the laws, policies, politics and culture of the sector
- › **The right people** – we are technically excellent, strategic, practical, experienced and efficient; our advisors are hand-picked based on having the right attributes to work successfully with your team
- › **The right skills** – we combine big-picture strategy with attention to detail in implementation
- › **The right experience** – we have advised on some of the most complex and high-profile government matters in Australia.

If you have any questions regarding this presentation on The Contract Formation Process, or any of the topics covered (including tendering, contract drafting, contract negotiation or contract management) please contact the presenter.

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