

A Contract Law Primer For Business Persons & Administrators

NB: The following is intended as information only and not as legal advice. Contracts are a complicated area of the law and the following is general and non-exhaustive. Important exceptions and qualifications have been omitted. It is not intended as a substitute for legal advice and you should always seek legal advice on any legal matter of concern to you.

Why Know the Law?

Business people and administrators enter into contracts more often than they may realize. Often the letter they are sending or the telephone conversation they are having is creating a contractual relationship with another party. Basically, any agreement with another person involving a promise to pay some amount of money or to do some thing is likely a contract with legal consequences.

Furthermore, even when they know there are legal contractual issues, business people and administrators may be inclined to deal with some matters without seeking the benefit of legal advice. Certainly there will be cases where the value of the contract does not justify the cost of legal advice, (however you need to exercise extreme care here; for example the sale of a 50 cent bolt could lead to \$1,000,000 in liability if the bolt is defective). Sometimes it is simply done unwittingly. Consequently, some basic knowledge of contract law is important to every business person and administrator. Even if legal advice is being sought, such knowledge can only improve your understanding of what it is that his or her lawyer is, or should be, doing.

What a Contract Should Achieve

Simply stated the purpose of a written contract is to record, in written form, the mutual understandings of the parties. But, what goals should a contract try to achieve?

A person drafting a contract should be seeking to accomplish at least three goals for his or her organization. The first is to make the transaction legally effective; for example to ensure that a binding contract exists in law or, if applicable, that a conveyance of legal title has occurred. The second is to ensure that your organization has been adequately protected; so that if a dispute arises, the desired result will ultimately prevail in a court of law.

The third goal is often over looked yet it is of paramount importance and that is the prevention of legal disputes altogether. Litigation is time consuming, disruptive, and extremely expensive. However, legal disputes do not often occur when there is nothing to fight about. When there are clear and exhaustive contractual terms setting out the parties' respective rights and responsibilities and specifying how the parties are to deal with a given problem or situation, then the parties will generally follow those rules and litigation can be avoided. When there is ambiguity about the rules because of ambiguous wording or because an unanticipated event has arisen, that is when you will most often have litigation.

Uncertainty

Uncertainty is the major problem with contracts drafted by non-lawyers. Uncertainty can void the whole contract or just the offending clause (if it is not a fundamental clause). The courts will strive to give meaning to every contractual clause and are reluctant to find uncertainty but if the Court finds that impossible, the whole contract (or offending clause) might be unenforceable, or, possibly worse, the Court may give the clause a meaning that you never intended and which could cause you great economic harm.

There are several kinds of uncertainty:

1. Ambiguous wording:

You and the other party may have different ideas about what was actually agreed to and the wording you have employed may support both interpretations. Thus, you may think you have an agreement but in fact there was no "meeting of the minds".

When drafting, ask yourself if the word or clause you have written is capable of two or more meanings; for example, suppose you sell a building with the term "Vendor will repair roof". The Vendor may think that involves a few patches. The Purchaser may think it involves replacing the whole roof.

Try the "person off the street" test. Ask yourself (and be brutally honest) "would someone who just came in off the street understand this clause and, if so, what would he think, and what could he think, it means?"

2. Missing an essential term:

Some terms are so fundamental to a particular contract that if they are missing, the whole contract may be void. For example, price is usually a fundamental term as is a description of the goods, property or services that is being paid for. Also, if "time is of the essence" then dates are fundamental.

You need to be extremely careful that any of the fundamental aspects of the deal are actually in the contract and that they are worded unambiguously.

3. Agreement to agree:

You can't contractually agree to agree upon something later. If you leave something to be agreed to later, then you do not have an agreement or contract on that point. If the thing to be agreed to later is fundamental to the agreement (eg. price) then the whole contract may be void.

A common example of an agreement to agree is an option to renew a contract at a price "to be agreed". In that example the option is probably void for uncertainty. This problem can sometimes be resolved by having (as part of the contract) a clear method for arriving at a decision if the parties can't agree - eg. binding arbitration or letting a third party decide (you can even let one of parties decide if the other is prepared to take that risk).

4. Not dealing with eventualities, issues and the "what ifs":

In putting together a contract you need to make sure that you have dealt with all of the major issues and questions that are likely to arise as the contract is performed. Have you considered what will happen if the unexpected or undesirable happens? And what happens then? This is not, strictly speaking, an uncertainty problem, although it is what often leads to law suits. If there is no advance agreement on how to deal with an issue that has arisen, the parties may end up fighting over it.

Offer and Acceptance

All contracts are formed by a process of offer followed by unconditional acceptance (a conditional acceptance is regarded as a rejection of the existing offer - it is a counter offer which must then be unconditionally accepted by the other party before there will be a contract).

With respect to an offer and acceptance, keep in mind the following:

1. If you counter offer, the other side is under no obligation to accept your counter offer, or to revive their original offer.

2. Once you have accepted an offer, you cannot change any of the terms (even immediately afterwards) unless the other side lets you.

3. You cannot accept an offer by making changes - eg. if you say "I accept your offer subject to just one minor change", or "I accept if ..." or "I accept but ..." then your acceptance is not unconditional and you do not yet have a contract. All you have at that point is a counteroffer. Also, you cannot assume that the other party's silence is acceptance of your changes. The other side has to expressly accept your change before there is a contract.

Generally, an offer can be revoked at any time, even before the expiration of a specified time limit. However, there are exceptions to this general rule. Where the offeror has been paid or promised something to keep the offer open (this is really what an "option" is) or in some cases where the offer is for the purchase or sale of goods in an international context (if the International Sale of Goods Act applies eg. With a customer in the U.S.), then the offer cannot be revoked unless you expressly give yourself that right in the wording of the offer.

Oral Contracts

Generally a contract is perfectly "legal" and enforceable against you, even if it is not in writing. An oral contract is just harder to prove in a court of law. Even a written contract (unless it says otherwise) can have additional oral or implied terms, and can also be orally amended or terminated so you need to be careful when engaged in verbal discussions about a contract. If you want the written terms of the contract to be the entire contract, then you should say so. If you do not want the law to imply any terms then you should say so.

Personal guarantees and contracts involving an interest in land do need to be in writing in order to be enforceable. However if they are not in writing they may still be valid. For example, the vendor may keep a deposit given on an oral contract for the purchase of land if the purchaser fails to complete (there are exceptions to this exception).

Illegal Contracts

A contract to further an "unlawful" purpose may be void. The term "unlawful" is not restricted to criminal activities and includes such things as breach of contract, inducing breach of contract, violation of securities regulations, trespass, and breaching public health or environmental regulations.

For example, where a contract contemplates that one party will breach a legal obligation owed to another person, (as, for example, where a party signs an employment contract in contravention of a non-competition agreement) that contract may be void because it is unlawful. Similarly where your contract contemplates the breach of someone else's patent or copyright, it may be void. A promise by the other party to protect you and cover your costs if you are sued or prosecuted for doing the unlawful thing could also be unenforceable and worthless for the same reason.

Parties

Always remember that, in law, a corporation is its own person, distinct and separate from its shareholders. A contract with a corporation is not a contract with its shareholders and hence your only legal recourse will be against the legal entity that you actually contract with and not (normally) against the shareholders who own the corporation.

If you are entering into a contract with a corporation consider conducting a corporate search to make sure the corporation really exists and that you have the correct name (corporate searches can be done through lawyers offices or, in Alberta, most private license registries). Also, consider the following issues:

1. A corporation has limited liability, and thus you can only claim damages, the repayment of money, or other remedies from the corporation itself and not its shareholders. Always ask yourself if this corporation will be able to pay or carry out its other obligations under your contract.

2. Some clauses, such as restrictive covenants and confidentiality clauses, are largely ineffective if they only bind the corporation itself and not its shareholders or important employees. Consider whether you need to have those other people sign the agreement as well.
3. A contract with a corporation is not binding on its subsidiaries unless they also sign.

If your own organization is a body corporate, make sure you sign under the full and correct corporate name (even if you are using a trade name) eg. "Joe's Garage (1972) Ltd.". Otherwise the contract may be void or you may become personally responsible under that contract. If you are a "for profit" company, never leave out the "Ltd.", "Inc." or "Corp." in your name - otherwise you risk personal liability. If you are signing cheques, contracts or other documents as an employee or officer of a body corporate, make sure that it is made clear that you are signing in that capacity (or you risk personal responsibility) eg.

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Miscellaneous Considerations in Reviewing and Drafting Contracts

Here are some very general items to consider adding when negotiating or drafting a contract where you are providing goods or service or when reviewing another party's contract to sell or provide you with goods or services. If the item would protect you consider adding it to your contract. If the clause is in the contract you are reviewing and protects the other side, consider whether it is fair and appropriate and whether you should try to delete it:

1. A contractual limitation period for claims under the contract. In other words a clause that states that claims cannot be brought against you after a certain date or a certain event.
2. Goods or services supplied are deemed satisfactory unless notice of defect is given within a given period of time.
3. Limitations on damages. For example, some contracts provide that in the event of defects in the goods or services liability is limited to a refund.
4. An obligation to reimburse solicitor-client costs (i.e. actual legal fees) if a party has to sue to collect or enforce the agreement.
5. Interest on late payments (generally a high flat annual rate is preferable to "prime plus" formulas).
6. Make sure it is spelt out clearly and completely what it is you are bound to do (and that you are not obliged to do) and what the other party is bound to do. Don't leave it to implication.
7. Make sure it is spelt out specifically what it is you (or the other side) are promising about the quality, nature and extent of what will be provided or done. In your case specifically say that you make no other promises; otherwise the law may imply more promises than you intended.
8. Always think through the "what ifs" eg. what if goods can't be delivered in time, what if some one else does not do what they are suppose to do, what if the unexpected happens, etc.
9. Particularly in reviewing someone else's contract, beware of the "entire agreement clause". This is a clause that says that the document you are signing is the whole agreement and that the other party has not promised you anything else - is this really the case? If you have relied on representations and promises in deciding to enter into the contract, and these representations and promises are not repeated in the contract, a clause like this may take away your right to rely on them.

10. Do not fall into the trap of signing something that is inconsistent with your understanding of what the deal is. Don't rely on the belief that "well, we all know what we really mean". If you have a lawsuit, something called the "parol evidence" rule will prevent you from introducing any evidence to contradict what the agreement says. You will be stuck with the written agreement.

11. Do you have other contracts with the same party? Is there anything about this contract which might be inconsistent with the other contracts? If so how are you going to deal with that inconsistency?

12. Be aware of the "privity" rule - only actual parties to a contract can enforce it - others cannot, even if they benefit from it.

13. A personal guarantee from an individual, (i.e., an agreement where one person guarantees the performance of an obligation by another person) as opposed to a company is not enforceable in Alberta unless it is in writing and attached to a completed notarial certificate.

Standard Form Contracts

Be cautious about printed forms or so called "standard form" contracts. They will almost invariably be worded in a manner which heavily, and sometimes even unfairly, favours the other party (see Miscellaneous Considerations above). For example, look for clauses in which the other party disclaims responsibility or is given excuses for non-performance or passes risk and liability over to you (depending on the circumstances and nature of the deal, these kinds of clauses will sometimes be reasonable but often they are not).

Do not think that just because a contract is in a printed form that you do not need to read it or that you lack the ability or right to negotiate changes or that there is no need to seek legal advice; the opposite is more likely to be the case. Contract rules are the same whether the form is nicely printed or is handwritten on a napkin. In trying to remove or reword offensive clauses don't be dissuaded by comments like "well this is our standard form and all of our customers sign it as is - why should you be different?" or "you're being overly cautious and academic - we would never actually enforce that clause against you" or "you're being silly and we are amazed that you would even raise the point - we've been using this form for 10 years and you're the only one out of hundreds of customers to ever complain about our form". Stick to your guns unless and until you are sure that you simply must deal with this party and have no choice but to sign.

Always be aware of the general rule that if you sign a contract, it is presumed that you read and understood it and agreed to every single term in it, even the "small print" - read before you sign.

If the contract is not signed (ie. parking lot tickets, ski lift tickets, disclaimer signs) then you are only bound by the terms that a reasonable person would have actually noticed at or before (but not after) the time the contract was entered into.

Generally, in reviewing a contract's clauses always ask yourself, "Why is this here?" and "Do I understand what this really means?". Is it reasonable to have it there or does it simply give an unfair benefit or protection for the other side? If it does provide a benefit or protection for the other side, should you have it too? Is there a purpose to the clause that you do not understand? Also, do you feel comfortable that you appreciate all the implications of that clause?

Remedies for Breach of Contract

If the other party commits a major breach of the contract that is serious enough (ie. where it fundamentally impacts the deal) then you may either sue for damages or back out of the agreement altogether ("rescission").

If you choose to rescind, the danger is that a court will later decide that the breach was not serious enough and then it will be you who is in the wrong. Consequently, it is safest to spell out in the contract the kind of defaults that give a party the right to rescind/terminate and the kind that do not.

Minor breaches by the other party only entitle you to damages, i.e., monetary compensation for your actual and proven losses.

You can also sue for "specific performance" (i.e., a court order forcing the other party to comply with the contract) but this is an "equitable" remedy that is in the discretion of the courts. The Court will consider, for example, if you come to court with "clean hands" (i.e., there can be nothing in your own conduct which is reprehensible) and will usually only grant you this remedy if you can show that you cannot be adequately compensated with money.

Having a right to claim damages does not mean that you will be able to collect (see "Parties" above). For this reason, it is often advisable to require the other party to have liability insurance (possibly with you as a named insured) and to provide you with evidence that they have placed it. This will not usually help you collect delinquent payments, but may help you recover claims against the other party for negligence and other "torts".

Housekeeping

A contract is an important document and is very much alive during the course of its performance. It is important, therefore, to keep an original copy of the contract available for review at all times and also to ensure you have methods to deal with some of the following issues:

1. Be sure that someone in your organization is actually charged with the obligation of following up to ensure that the other party to the contract is performing its obligations.
2. Many contracts contain important dates that need to be diarized and brought to the attention of a responsible person in your organization. For example: some agreements (ie. leases) contain deadlines by which time you must exercise your options or rights of renewal. Some agreements contain deadlines for claiming deficiencies or defaults. Some agreements will automatically renew (so called "evergreen" clauses) unless you notify the other party to the contrary by a stipulated deadline.
3. It should be clear within your organization who has the authority to sign contracts or contracts of a particular dollar amount or type.
4. It should be clear within your organization what sort of contracts will commonly be referred out for legal advice.
5. There could be more to a contract than just the one document you have signed. For this reason it is important to keep your contract, together with all other correspondence, memos and documents pertaining to the subject matter of the contract, in the same file location.
6. It is common for a contract to stipulate an address at which important notices under that contract may be served. It is important to maintain a list of the contracts where you have stipulated such an address so that if you ever move you can be sure that you notify the other party of your change of address.

Generally

When you do the final review of a contract ask yourself if there are any reasonably foreseeable eventualities or business issues that have not been dealt with and, if so, whether there was good reason for omitting them. Also remind yourself that while you will obviously have a very good idea of what the contract is intended to say, others may disagree. Ask yourself if a person off the street would agree that there are no other possible interpretations. Or try and imagine yourself in the position of the opposing party trying to pick your agreement apart. If your answer is that other interpretations are possible, then you know you have a problem and this is so even if you find yourself saying "but any sensible judge would find in my favour". The findings of real judges (most of whom, incidentally, will have very little familiarity with your organization's type of business) may surprise you and, in any event, you will be missing the point that getting to a judge in the first place presupposes many months of the very litigation you should have been trying to avoid.



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If you are asked to sign a "standard form" contract do not just assume that it must be okay. Read it carefully and make sure you understand it before signing.

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