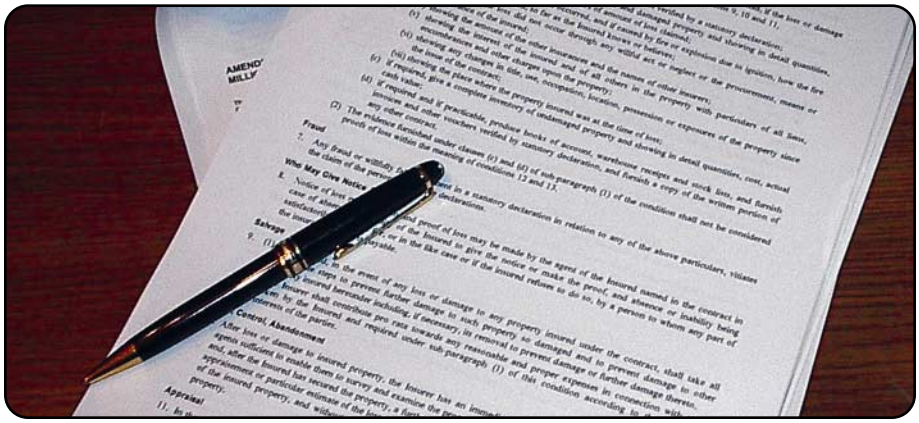


Significant contracts should be recorded for future certainty

CHAPTER 3

Formation of a Valid Contract

ASK A LAWYER

Chemical Products Co. produces a line of complex chemical products. Production requires great skill and ability to ensure the correct composition of each product. The company is interested in the testing and purchase of a special computer-driven machine that might handle the movement and mixing of the company's product. However, any employee hired to operate the machine would have access to the company's secret recipes and production secrets. Management seeks advice as to how it might reduce its risks in its purchase and in the hiring of an employee.

What advice might the lawyer give?

LEARNING GOALS

1. To examine the role of contracts in business.
2. To understand the elements of a valid contract.
3. To determine how contracts are formed.
4. To outline the rules relating to the creation of a valid contract.
5. To understand the legal obligation of privacy and data protection.

YOUR BUSINESS AT RISK

Almost all of your business activity will be governed by contracts, and you must learn how to create contracts correctly. If a contract is not created correctly, it does not come into existence, and this is a dangerous circumstance. If the other party to your transaction abandons the deal or falls short in performance, you will have incurred time and expense for nothing. You will be left with little or no means to enforce your "rights," as no contract ever existed.

3.1 INTRODUCTION

Contract law is an area of the law that relates almost exclusively to business transactions. Goods are bought, sold, and moved by way of contract; employees are hired under contract; land and buildings are developed, bought, sold, financed or leased under contract; business risk is reduced by the contract of insurance; and, indeed, many businesses, such as partnerships, are based on contracts. In a sense, contracts represent the foundation of most commercial activities, and consequently, contract law represents one of the most important areas of business law.

Contract
An agreement enforceable at law.

A **contract** may be defined as an agreement made between two or more corporations or persons that the courts will enforce. Contract law differs from many other areas of the law in that the parties need only follow the principles set out in the law to create their own rights and duties that the courts will then enforce. In some respects, the parties create their own "law" that they are obliged to follow.

3.2 THE ELEMENTS OF A VALID CONTRACT

The creation of a binding contract that the courts will enforce requires the contracting parties to meet a number of requirements that are prescribed by the law of contract. While these requirements are not numerous, they must, nevertheless, be met before the agreement creates rights and duties that may be enforceable at law. These requirements are referred to as the elements of a valid contract and consist of the following:

1. An intention to create a legal relationship
2. Offer
3. Acceptance
4. Consideration
5. Capacity to contract
6. Legality

In addition to the six basic elements, certain types of contracts must be in writing, in an electronic substitute, or take on a special form, to be enforceable. But in general, all contracts must have these six elements present to be valid and binding. In this chapter, the six elements are examined, in order to identify the rules applicable to the establishment of these requirements for a contract.

3.3 THE INTENTION TO CREATE A LEGAL RELATIONSHIP

The concept of a contract as a bargain or agreement struck by two parties is based upon the premise that the end results will be a meeting of the parties' minds on the terms and conditions that will form their agreement with each other. Each will normally agree to do, or perhaps not do, certain things in return for the promise of the other to do certain things of a particular nature. In the process of reaching this meeting of the minds, the parties must establish certain elements of the contract itself.

One of the essential elements of an agreement is a promise. Obviously, not all promises can be taken as binding on the party making them. Some may be made by persons with no intention of becoming legally obligated to fulfill them, for example, promises made between family members. This type of promise cannot be taken as the basis for a contract. The first requirement, then, for a valid contract must be the intention on the part of the person making a promise (the promisor) to be bound by the promise made. This intention to create a legal relationship is an essential element of a valid contract. It is generally presumed to exist at law in any commercial transaction where the parties are dealing with one another at arm's length.

CASE LAW

An Expensive Comma: With one year's notice, Aliant terminated a contract it had with Rogers Communications. Rogers felt it should get the benefit of a full five-year locked-in term, before anything could be terminated. The agreement stated it "shall continue in force for a period of five years from the date it is made, and thereafter for successive five year terms, unless and until terminated by one year prior notice in writing by either party." Rogers felt the deal had to last at least five years; Aliant thought it could get out within a year. English professors have given round 1 to Aliant, saying the second comma allows the notice period to modify the whole sentence. Extra fees of over $2-million will apply in order to revive the deal. Was there a meeting of minds? The matter will begin its journey before the courts in 2007.

Presumption at law
Believed to be so unless the contrary is proved.

The intention to create a legal relationship is a **presumption at law** because the creation of the intention would otherwise be difficult to prove. If the intention is denied, the courts will usually use the conduct of the party at the time that the statements were made as a test and examine the conduct and statements from the point of view of the "*reasonable person*."

Advertisements

The reason for the presumption that strangers who make promises to one another intend to be bound by them permits the courts to assume that the promises are binding, unless one or both of the parties can satisfy the court that they were not intended to be so. The law, nevertheless, recognizes certain kinds of promises or statements as ones that are normally not binding, unless established as such by the evidence. For example, advertisements in newspapers/magazines are not normally taken as enforceable promises that are binding on the advertiser.

The basis for this exception is for the most part obvious. Advertisers, in the presentation of their goods to the public, are permitted to describe their products with some latitude and enthusiasm, provided, of course, that they do not mislead the prospective purchaser. While advertisers are not normally subject to the presumption that their promises represent an intention to create a legal relationship, they may, nevertheless, be bound by their promises if the party accepting their promises can convince a court that the promisor intended to be bound by the promise.

An early example of this point was a British case[1] which involved a drug manufacturer that advertised its product as a cure for influenza. The company had promised in its advertisement that it would pay £100 to anyone who used the product according to the prescribed directions and later contracted the illness. The advertisement also contained a statement to the effect that it intended to be bound by its promise and that to show its good faith, it had deposited a sum of money for this purpose with a particular bank. When a person who had purchased and used the product according to the instructions later fell ill with influenza and claimed the £100, the company refused to pay, on the basis that it did not intend to create a legal relationship by simply advertising its product. The court held, however, that it had, by its words in the advertisement, clearly expressed the intention to be bound and, accordingly, could not later avoid or deny it.

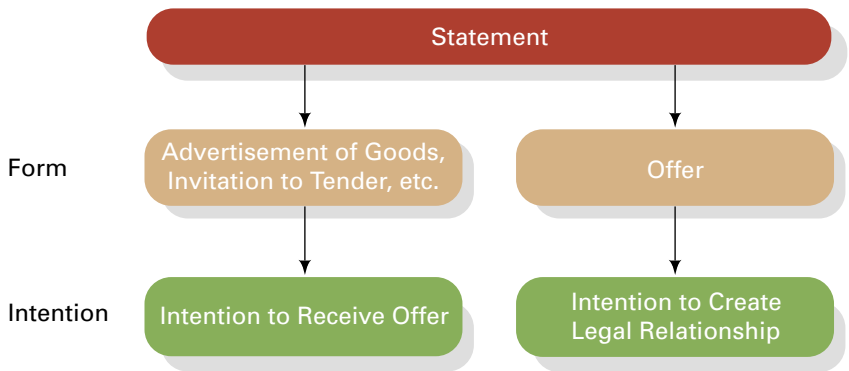
The rule that can be drawn from this case is that while an advertiser is not normally bound by the claims set out in an advertisement, if a clear intention to be bound by it is expressed in the advertisement, then the courts will treat the promise as one made with an intention to create a legal relationship.

Invitation to do business
A business solicitation lacking the intention to be bound.

As a general rule, the courts view an advertisement (or for that matter, any display of goods) as an **invitation to do business**, rather than an intention to enter into a contract with the public at large. The purpose of the advertisement or display is merely to invite offers that the seller may accept or reject. This particular point becomes important in determining when a contract is made where goods are displayed for sale in a self-serve establishment. The issue was decided in a British case[2] where the court held that the display of goods in a self-serve store was not an offer to sell the goods to the public but only an invitation to the public to examine the goods and, if the person desired, to offer to purchase the goods at the check-out counter.

The mere possession of the goods by the prospective purchaser was of no consequence, as the offer to purchase and the acceptance of the offer by the seller did not take place until the seller dealt with the goods at the check-out counter. It was at this point in time that the contract was made and not before.

FIGURE 3–1
Intention of the Parties



1 *Carlill v. Carbolic Smoke Ball Co.*, [1893] 1 Q.B. 256.
2 *Pharmaceutical Society of Great Britain v. Boots Chemists (Southern) Ltd.*, [1952] 2 All E.R. 456.

3.4 OFFER AND ACCEPTANCE

The Nature of an Offer

The second element of a binding contract deals with promises made by the parties. Only a promise made with the intention of creating a legal relationship may be enforced. But in the normal course of negotiations, a person (the promisor) seldom makes such a promise unless some condition is attached to it, requiring the other party (the promisee) to do some act or give a promise in exchange. Consequently, such a promise is only tentative until the other party expresses a willingness to comply with the condition. The tentative promise (called an **offer**) made subject to a condition is, therefore, not binding on the offering party (the promisor or **offeror**) until the proposal is accepted. It is only when a valid acceptance takes place that the parties may be bound by the agreement. These two additional requirements constitute the second and third elements of a valid contract: offer and acceptance.

Offer
A promise subject to a condition.

Offeror
The person making an offer.

Communication of an Offer

It is important to note that an offer must be *communicated* by the offeror to the other party (the **offeree**) before the offer can be accepted. From this observation, we have the first rule for offer and acceptance: *An offer must be communicated by the offeror to the offeree before acceptance may take place.*

Offeree
The person who receives an offer from another party.

This rule may appear to be obvious, but an offer is not always made directly to the offeree by the offeror. In some cases, the parties may deal with each other by letter, telegraph, telex, fax, e-mail, or a variety of other means of communication. Consequently, it is important for the offeror to know when the offeree becomes aware of the offer. This is so because an offer is not valid until it is received by the offeree, and the offeror is not bound by the offer until such time as it is accepted. The essential point to make here is that no person can agree to an offer unless he or she is aware of it.

If the acceptance takes place before the offer is made, the offeror is not bound by the promise. This is particularly true in the case of offers of *reward*.

EXAMPLE

A company had a large corporate banner that was flown from a flag mast outside its downtown corporate office. During a wind storm, the banner disappeared, and the company decided to place an advertisement in the local newspaper offering a reward of $200 for its return. Before the advertisement appeared in the newspaper, an employee of another company located nearby found the banner and returned it to the receptionist at the corporate office. Later that day, the employee noticed the reward advertisement in the newspaper and made a claim for the reward.

In this case, the offer of reward was not communicated to the employee until after he had performed what was required under the terms of the offer of reward. The employee, therefore, cannot accept the offer because he had returned the banner without the intention of creating a contract. This concept will be examined more closely with respect to another element of a contract, but for the present, it may be taken as an example of the communication rule.

A person who makes an offer frequently directs it to a specific person, rather than to the public at large because the offeror may wish to deal with a specific person for a variety of good reasons. For example, a seller of a specific type of goods may wish to sell the goods only to those persons trained in the use of the goods if some danger is attached to their use. Hence, we have a second general rule that *only the person to whom an offer is made may accept the offer*. If an offer is made to the public at large, this rule naturally does not apply; for the offeror is, by either words or conduct, implying that the identity of the offeree is not important in the contract.

Acceptance of an Offer

Acceptance
Agreement of the offeree to the terms of the offer.

While both an offer and its **acceptance** may be made or inferred from the words or the conduct of the parties, the words or conduct must conform to certain rules that have been established before the acceptance will be valid. These rules have been formulated by the courts over the years as a result of the many contract disputes that came before them. At present, the major rules for acceptance are well established.

The first general rule for acceptance where a response is necessary is simply the reverse of the rule for offers. It states that *the acceptance of the offer must be communicated to the offeror in the manner requested or implied by the offeror in the offer*. The acceptance must take the form of certain words or acts in accordance with the offer that will indicate to the offeror that the offeree has accepted the offer. These words or conduct need not normally be precise, but they must convey the offeree's intentions to the offeror in the manner contemplated for acceptance.

EXAMPLE

If the purchasing manager of a corporation writes a letter to a seller of a particular product stating that the corporation wishes to purchase a given quantity of the goods at the seller's advertised price and requests that the goods be sent to the corporation, the letter would constitute an offer to purchase. The acceptance would take place when the seller acted in accordance with the instructions for acceptance set out in the letter. It would not be necessary for the seller to write a reply conveying acceptance of the offer because the offer contemplates acceptance by the act of sending the goods to the offeror. The acceptance would be complete when the seller did everything required by the terms of the offer contained in the letter.

In the case of an offer requiring some expression of acceptance by written or spoken words, a number of specific rules for acceptance have been set down. If acceptance is specified to be verbal, the acceptance would be complete when the acceptance is communicated by the offeree either by telephone or when the offeree meets with the offeror and speaks the words of acceptance directly to the offeror. With this form of acceptance, there is no question about the communication of the words of acceptance. It takes place when the words are spoken.

The time of acceptance, however, is sometimes not as clear-cut with other modes of acceptance, and the courts have been called upon to decide the issues as the particular modes of acceptance came before them. In the case of an offer that invites acceptance by mail, the rule that has been established is that the *acceptance of the offer takes place when the letter of acceptance, properly addressed and the postage paid, is placed in the postbox or post office*. The reasoning behind this decision is sensible. The offeree, in preparing a letter of acceptance and delivering it to the

post office, has done everything possible to accept the offer when the letter moves into the custody of the postal system. If the acceptance should be lost while in the the post office, the contract would still be binding, as it was formed when the letter was posted. The offeror, by not specifying that acceptance would not be complete until the letter is received, assumes the risk of loss by the post office and any uncertainty that might accompany this specified mode of acceptance. The courts have also held that where an offer does not specifically state that the mail should be used for acceptance but where it is the usual or contemplated mode of acceptance, then the posting of the letter of acceptance will constitute acceptance of the offer.

For all other modes of communication, the acceptance would not be complete until the offeror was made aware of the acceptance.

Electronic Contracts

With electronic means of communication, it is not uncommon for a business to offer goods or information for sale via the Internet. This raises the question of timing and acceptance of an offer made by an offeror. Because offerors may be located anywhere in the world, it is important for the parties to specify when and where an offer may be accepted and, in the case of foreign parties, the law that will apply to any agreement made.

For greater certainty (from the offeror's point of view), the applicable law is usually specified to be the law of the place where the offeror carries on business, and the acceptance of the contract by an offeree would render the offeree bound by laws of contract of the country, state, or province where the offeror is located.

It is important to note, however, that the parties are free to negotiate whatever terms they may wish to be included in a contract, and these terms would govern the contractual relationship once the contract was made.

The most common type of Internet offer is for the sale of goods or information, and in these instances, the offeror usually sets out the terms and conditions of the offer on a "take it or leave it" basis. The general format of this type of offer is to provide a "click box" on the screen, accompanied by the printed words "I agree." The clicking of this box would constitute acceptance of the agreement and the formation of a contract between the parties.

While there are very few decided cases concerning electronic contract formation, the Superior Court in Ontario did review the process in a case on point,[3] and the judge concluded that scrolling through the terms of the offer on the screen was similar to turning the pages of a written contract, and the clicking of the box "I agree" was the equivalent of a written acceptance of the terms of the offer.

Electronic commerce legislation in most provinces now provides that offer and acceptance may take place by the touching or clicking on an appropriate icon, box, or other item on a computer screen or via voice activation by the spoken word. Apart from these methods of offer and acceptance that apply to electronic means of presentation of the terms and conditions of the offer, most of the other rules relating to offer and acceptance will apply to the relationship.

3 *Rudder v. Microsoft Corp.* (1999), 47 C.C.L.T. (2d) 168.

CASE LAW

An Internet access company offered its services to potential customers by way of a membership agreement. Potential customers were directed to scroll down through the agreement and, if satisfied with the terms (including the monthly fee), were directed to click on a box. By clicking the "I agree" box, membership and online access would be granted to the member.

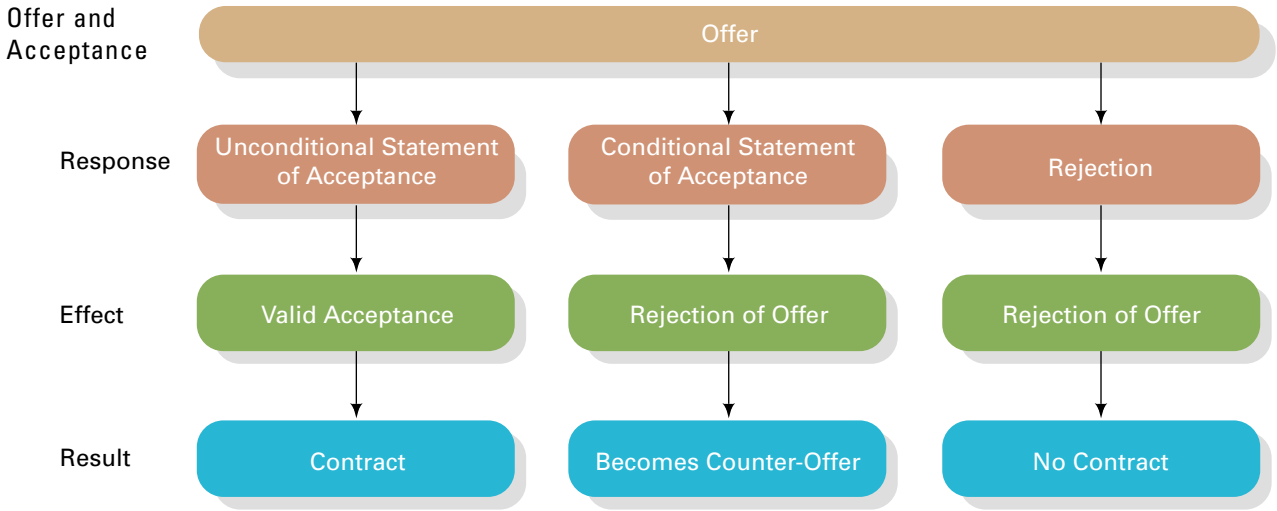
A user of the service wished to terminate his membership, claiming that the provider was in breach of the contract by failing to provide accurate information about the accounts chargeable to his credit card.

When no agreement could be reached, the user (and others) joined in a court case against the Internet company for breach of contract.

At trial, the judge examined the sign-up process and observed that scrolling through the agreement and then clicking the "I agree" box on the screen was the equivalent of examining the pages of a written contract and then signing the last page. The court concluded that the user was bound by the agreement and dismissed the case.

Rudder v. Microsoft Corp. (1999), 47 C.C.L.T. (2d) 168.

FIGURE 3–2



Counter-offer

A number of other rules also apply to acceptance in addition to the rules relating to time and place. When an offer is made, the only binding acceptance would be one that clearly and unconditionally accepted the offeror's promise and complied with any accompanying condition imposed by the offeror. Anything less than this would constitute either a **counter-offer**, or an *inquiry*. If an acceptance is not unconditional but changes the terms, then it would have the effect of rejecting the original offer and would represent a new offer (called a counter-offer) that the original offeror could then either accept or reject.

Counter-offer
A conditional acceptance which negates an offer and is itself an offer.

EXAMPLE

Acme Truck Sales sends a letter to Jones Transport, in which it offers to sell Jones transport a used five-tonne truck for $25,000 cash. Jones Transport writes a letter of reply, in which it "accepts" Acme Truck Sales's offer but states that it will buy the truck on the payment of $10,000 cash and give a promissory note for $15,000 to be payable $1,000 per month over a 15-month period.

In this example, Acme Truck Sales's offer is to sell a truck for a cash payment of $25,000. Jones Transport has expressed its willingness to purchase the truck but has changed the offer by altering the payment provision from $25,000 cash to $10,000 cash and a promissory note for $15,000. The change in terms represents for Acme Truck Sales (who now becomes the offeree) a counter-offer that it may accept or reject. The counter-offer submitted by Jones Transport has the effect of terminating the original offer that was made by Acme Truck Sales. If Acme Truck Sales should reject the counter-offer, Jones Transport may not accept the original offer unless Acme Truck Sales wishes to revive it.

The desirable approach for Jones Transport to follow in a situation where some aspect of the offer is unacceptable to it would be to inquire if Acme Truck Sales would be willing to modify the terms of payment before a response is made to the offer in a definite manner. In this fashion, it might still retain the opportunity to accept the original offer if Acme Truck Sales should be unwilling to modify its terms of payment.

CASE LAW

The Upper Clements Family Theme Park Limited had contracted for the services of the Lowe Company for several construction projects at its theme park. During work on their projects, Lowe had advised the theme park company that it had a number of different kinds of construction equipment available for lease, including a crane.

Some time later, the theme park company urgently required a crane to erect the steel structures for a large water slide and contracted Lowe Company. The crane was inspected by theme park management employees and found to be suitable for the job. Lowe Company informed the theme park construction manager that the crane rental would be $10,000 per month and available for a fixed two-month term. This was acceptable to the manager but he advised Lowe that only the general manager of the theme park could accept the terms of the lease.

The general manager of theme park, on being informed of the terms, wrote to Lowe Company, advising that $10,000 per month was acceptable on a pro-rated basis for the use for partial months hired, provided Lowe supplied fuel and maintenance. The letter provided that if these terms were acceptable, Lowe should sign one copy and return it. Lowe did not do so but delivered the crane to the park where it was used for several days. Lowe objected to the terms of the letter and insisted that the lease be for two full months. He, however, was prepared to reduce the monthly rental to $9,500 to allow for fuel and maintenance expense. The theme park manager refused these terms, and when no agreement was reached, the crane was retuned to Lowe. The theme park offered $1,250 as payment for the use of the crane. Payment was refused by Lowe, and Lowe sued for the full two months' use of the crane.

The court reviewed the negotiations by the parties and concluded that the letter by the theme park rejected the original offer and constituted a counter-offer that was accepted by delivery of the crane. Because the counter-offer provided for partial month use, Lowe was only entitled to rental for actual use of $1,250.

D.J. Lowe [1980] Ltd. v. Upper Clements Family Theme Park Ltd. (1990), 95 N.S.R. (2d) 397.

Silence

A somewhat different matter is a rule stating that silence cannot be considered acceptance unless a pre-existing agreement to this effect has been established between the parties. The rationale for this rule is obvious. The offeree should not be obligated to refuse an offer, nor should the offeree be obliged to comply with an offer simply because he or she has failed to reject it. The only exception to this rule would be where the offeree has clearly consented to be bound by this type of arrangement.

The question of whether a pre-existing agreement exists that would make silence acceptance is not always answerable in a definitive way. In some cases, persons may conduct themselves in such a way that even though they remain silent in terms of acceptance, they lead the offeror to believe that acceptance has been made of the offer. This is particularly true where a person offers to perform a service with the intention of receiving payment for the service, and the offeree stands by in silence while the service is performed, with full knowledge that the offeror expects payment. Under these circumstances, the offeree would have an obligation to immediately stop the offeror from performing or reject the offer.

It is important to note that this exception to the silence rule would normally apply to those situations where the offeree's actions constitute some form of acceptance. It would not apply, for example, where sellers send unsolicited goods to householders because no acceptance could take place before the delivery of the goods, at least in terms of communication of the interest to the seller.

Recent consumer protection legislation in a number of provinces has reinforced this Common Law rule. The legislation generally provides that members of the public shall not be obliged to pay for unsolicited goods delivered to them, nor should they be liable for the goods in any way due to their loss or damage while in their possession. Neither Common Law nor the legislation, however, affects a pre-existing arrangement whereby silence may constitute acceptance of a subsequent offer. This is a common characteristic of most book, compact disc (CD), and video "clubs." These clubs operate on the basis that a contract will be formed and the book, CD, or video will be delivered to the offeree if the offeree fails to respond to the offeror within a specific period of time after the offer has been made. Contracts of this nature are generally binding because silence is considered acceptance due to the pre-existing agreement governing the future contractual relationship of the parties.

Form of Acceptance

Acceptance, while it must be unconditional and made in accordance with the terms of the offer, may take many forms. The normal method of accepting an offer is to state or write, "I accept your offer," but acceptance may take other forms as well. For example, it may take the form of an affirmative nod of the head and a handshake. At an auction sale, it may take the form of the auctioneer dropping his hammer and saying, "sold," to the person making the final offer. Where a particular method of accepting the offer is specified, the offeree must, of course, comply with the requirements. If the offeror has stated in an offer that acceptance must only be made by a particular means, then the offeree, if he or she wishes to accept, must use this form of communication to make a valid acceptance. Offerors usually do not impose such rigid requirements for acceptance but often suggest that a particular method of communication would be preferred. In these cases, *if a method other than the method mentioned in the offer is selected, the acceptance would only be effective when it was received by the offeror.*

Electronic information or an electronic document is deemed[4] to be sent when it enters an information system outside the sender's control or, if the sender and the addressee use the same information system, when it becomes capable of being retrieved and processed by the addressee. It is presumed to be received by the addressee,

(a) if the addressee has designated or uses an information system for the purpose of receiving information or documents of the type sent, when it enters that information system and becomes capable of being retrieved and processed by the addressee; or,

(b) if the addressee has not designated or does not use an information system for the purpose of receiving information or documents of the type sent, when the addressee becomes aware of the information or document in the addressee's information system and it becomes capable of being retrieved and processed by the addressee.

It is also important to understand that validating electronic contracts is not the same as forcing their use, and thus parties are free to carry on using traditional paper. Just as with traditional contracts, electronic contractors may opt out of these statutory provisions (such as what constitutes the time of acceptance) and create their own terms of operation for electronic contracts and relationships.

Unilateral Agreements

Unilateral agreements
Contracts formed via offers which contemplate acceptance through performance of an act.

Offers that require offerees to complete their part of the contract as a mode of acceptance form a special class of contracts called **unilateral agreements**. These agreements usually do not call for the communication of acceptance before the contract is to be performed but, rather, signify that the offer may be accepted by the offeree completing his or her part of the agreement. Once completed, the offeror would then perform his or her part. On the surface, there would appear to be a danger with this mode of acceptance. If the offeror should withdraw the offer before the offeree has fully performed the acceptance, then no contract would exist, and any expense or inconvenience incurred by the offeree would not be recoverable. To remedy this situation, the courts have held that where an offeree is obliged to perform his or her part of the contract in order to accept the offer, then the offeror will not be permitted to withdraw the offer so long as the offeree is in the course of performing his or her part. This approach, however, assumes that the offeror has not expressly reserved the right to withdraw the offer at any time during the offeree's act of acceptance. The offer of reward for the return of a lost animal would be an example of a contract where the offer would be accepted by the act of the offeree.

CASE LAW

An equipment supply corporation had on many occasions leased equipment to a construction company under short-term equipment leases. On a number of occasions, the leased equipment was a gas welder, which weighed somewhere between 300 and 500 pounds. The equipment was usually ordered by telephone and delivered to the construction site, where an officer of the construction company would sign a standard lease contract that was drawn in accordance with the terms agreed upon in the telephone conversation.

On one occasion, a gas welder was ordered and delivered to the construction site along with the contract. No one from the company was available to sign

4 The federal government's *Personal Information Privacy and Electronic Documents Act* sets Canadian standards and applies to electronic transactions in provinces that have not enacted equivalent legislation.

the contract, but a workman at the site accepted delivery on the contract but did not sign the contract in the space provided for the company officer's signature. That evening, the gas welder was stolen from the work site and never recovered by the police.

The contract provided that the construction company was liable for any leased equipment that was not returned, and the equipment supply company demanded payment. The construction company refused to pay on the basis that it did not sign the contract. The equipment supply company sued for the value of the gas welder.

The court held that the construction company was liable for the price of the welder, as acceptance of the contract terms could be implied from the conduct of the construction company.

S & S Supply Ltd. v. Fasco Industries Ltd. (2002), 642 A.P.R. 166.

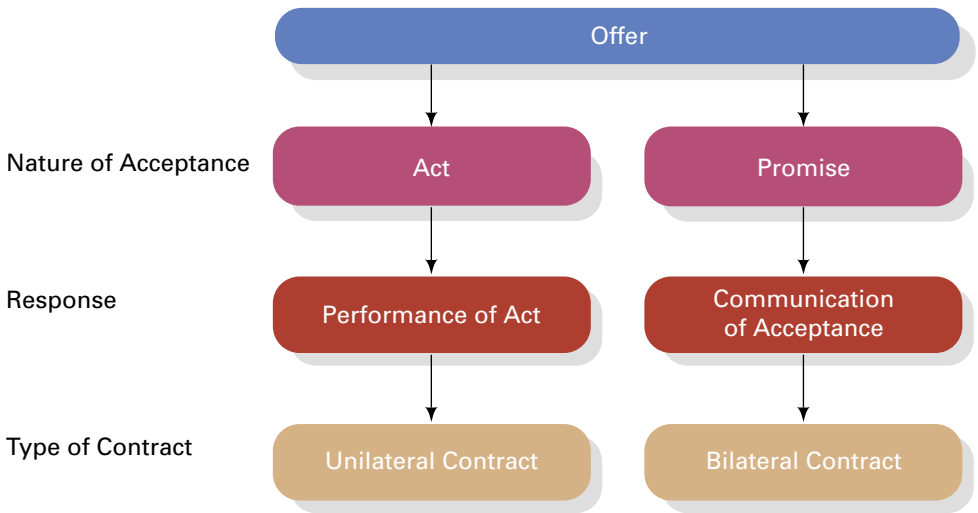
Lapse
The passage of time that results in termination of an offer.

Lapse of an Offer

Until an offer is accepted, no legal rights or obligations arise. Offers are not always accepted. Even in cases where the offeree may wish to accept, events may occur or conditions may change that will prevent the formation of the agreement. The death of either party, for example, will prevent the formation of the contract because the personal representative of the deceased normally may not complete the formalities for offer and acceptance on behalf of the deceased. When an offeree dies before accepting an offer, the offer lapses because the deceased's personal representative cannot accept an offer on behalf of a deceased person. By the same token, acceptance cannot be communicated to a deceased offeror, as the personal representative of the offeror would not be bound by the acceptance, except under special circumstances where the offeror has bound them to the offer. The same rule would hold true in the case of the bankruptcy of either of the parties or if a party should be declared insane before acceptance is made.

An offer will also lapse as a result of a direct or indirect response to the offer that does not accept the offer unconditionally and in accordance with its terms. If the offeree rejects the offer outright, it lapses and cannot be revived except by the offeror. Similarly, any change in the terms of the offer by the offeree's "acceptance" will cause the original offer to lapse, as the modified acceptance would constitute a counter-offer.

FIGURE 3–3
Forms of Acceptance



Offers may also lapse by the passage of time or the happening of a specified event. Obviously, an offer that must be accepted within a specified period of time or by a stipulated date will lapse if acceptance is not made within the period of time or by the stated date. An offer may also lapse within a reasonable time if no time of acceptance has been specified. What constitutes a reasonable time will depend upon the circumstances of the transaction and its subject matter. An offer to sell a truckload of perishable goods would have a much shorter "reasonable" time for acceptance than an offer to sell a truckload of nonperishable goods that are not subject to price or market fluctuation.

As a general rule, where an offer is made by a person in the company of another and where no time limit for acceptance is expressed, the offer is presumed to have lapsed when the other party departs without accepting the offer, unless the circumstances surrounding the offer would indicate otherwise.

Revocation of an Offer

Revocation
Withdrawal of an offer.

Revocation, as opposed to lapse, requires an act on the part of the offeror in order to be effective. Normally, the offeror must communicate the revocation to the offeree before the offer is accepted, otherwise the notice of revocation will be ineffective. With an ordinary contract, as a general rule, an offeror may revoke the offer at any time prior to acceptance, even where the offeror has gratuitously agreed to keep the offer open for a specified period of time. If the offeree wishes to make certain that the offeror will not revoke the offer, the method generally used is called an **option**. An option is a separate promise that obliges the offeror to keep the offer open for a specified period of time, either in return for some compensation or because the promise is made in a formal document under **seal**. The effect of the seal on a document will be examined later in the chapter, as will the effect of compensation paid to an offeror in return for the promise. However, for the present, it is sufficient to note that either of these two things will have the effect of requiring the offeror to keep the offer open for the specified period of time.

Option
An enforceable promise not to withdraw an offer.

Seal
A formal way of expressing the intention to be bound by a written promise or agreement. This expression usually takes the form of signing or affixing a wax or gummed paper wafer beside the signature, or making an engraved impression on the document itself.

A second aspect of revocation of an offer is that it need not be communicated in any special way to be effective. The only requirement is that the notice of revocation be brought to the attention of the offeree before the offer is accepted. This does not mean, however, that the same rules apply to revocation as to acceptance where some form of communication other than direct communication is used. Because the offeree must be aware of the revocation before it is effective, the courts have held that the posting of a letter revoking an offer previously made does not have the immediate effect of revoking the offer. The notice of revocation is only effective when it is finally received by the offeree. The same rule would apply to most other forms of communication.

The question of whether indirect notice of revocation will have the effect of revoking an offer is less clear. For example, Anderson Auto Sales offers to sell a car to Burton and promises to keep the offer open for three days. On the second day, Anderson Auto sells the car to Coulson. The sale of the car would clearly be evidence of Anderson Auto's intention to revoke the offer to sell to Burton. If a mutual friend of Burton and Coulson told Burton of the sale of the car to Coulson, would this indirect notice prevent Burton from accepting the offer? This very question arose in a British case in which an offer had been made to sell certain property and the offeree was given a number of days to accept. Before the time had expired, the offeror sold the property to another party, and a person not acting under the direction of the offeror

informed the offeree of the sale. The offeree then accepted the offer (within the time period for acceptance) and demanded conveyance of the property. The court held in this case that the offeree was informed of the sale by a reliable source and that this knowledge would not allow him to accept the offer.

The essential point to note in cases where notice of revocation is brought to the attention of the offeree by someone other than the offeror or the offeror's agent is the reliability of the source. The offeror must, of course, prove that the offeree had notice of the revocation before the offer was accepted. The onus would be on the offeror to satisfy the court that the reliability of the source of the knowledge was such that a reasonable person would accept the information as definite evidence that the offeror had withdrawn the offer. Cases of indirect notice, consequently, turn very much on the reliability of the source when the notice comes from some source other than the offeror or the offeror's agent.

LEARNING GOALS REVIEW

- Every contract requires an intention on the part of each party to enter into a binding agreement.
- Offer and acceptance are two other requirements of a binding contract.
- An offer must be communicated to the offeree before it may be accepted.
- Acceptance must be unqualified to be valid.
- To be effective, acceptance must be received by the offeror before the offer is revoked or lapses.

3.5 CONSIDERATION

Nature of Consideration

The bargain theory of contract suggests that a contract is essentially an agreement between parties where each gets something in return for his or her promise. If this is the case, then every promise by an offeror to do something must be conditional. The promise must include a provision that the offeree, by conveying acceptance, will promise something to the offeror. The "something" that the promisor receives in return for the promisor's promise is called **consideration**—an essential element of every simple contract.

Consideration
Something that has value in the eyes of the law and which a promisee receives in return for a promise.

Consideration can take many forms. It may be a payment of money, the performance of a particular service, a promise not to do something by the promisee, the relinquishment of a right, the delivery of property, or a many other things, including a promise in return for the promise. However, in every case, the consideration must be something done with respect to the promise offered by the promisor. Unless a promisor gets something in return for his or her promise, the promise is merely **gratuitous**. Generally, consideration for a promise must exist for the contract to be legally binding.

Gratuitous
Without compensation or counter-performance.

CASE LAW

Gilbert Steel agreed to supply steel for the construction of a number of apartment buildings that University Construction was erecting in three separate locations. The agreed price for the steel was $153 and $159 per tonne for the two required grades of steel. The first two buildings were completed at this price. Steel prices increased before building at the third location was to commence, and a new contract was entered into to supply steel for the buildings at $156 and $165 per tonne.

During construction, the prices of steel increased substantially and Gilbert Steel approached University Construction for an increase to $166 and $178 per tonne. Gilbert Steel prepared a new written contract containing these prices and two other clauses that the parties had not discussed. University Construction did not sign the agreement as a result and continued to pay for the steel but paying less than the invoiced amounts until a significant balance was owing. A dispute over amounts owing resulted in Gilbert Steel taking legal action.

The issue before the court concerned the enforceability of the oral agreement to pay the higher $166 and $178 per-tonne prices, since the written agreement provided only for payment at the $156 and $165 per-tonne rates.

The court concluded that no consideration existed for the promise to pay the higher per-tonne rates and that the oral agreement must fail on that basis.

Gilbert Steel Ltd. v. University Construction Ltd. (1976), 12 O.R. (2d) 19.

Adequacy of Consideration

In general, the courts are not concerned about the adequacy of consideration because they are reluctant to become involved in deciding the fairness of the price or value that a person receives for a promise. Apart from the requirement that the consideration be legal, their main concern is with the presence or absence of consideration, rather than whether the promisor received proper compensation for his or her promise. In some cases, however, the courts will look more closely at the adequacy of the consideration. If the promisor can satisfy the court that the promise was made under unusual circumstances (such as where an error occurred that rendered the consideration totally inadequate in relation to the promise made), the courts may intervene.

EXAMPLE

City Casting Co. wrote a letter to Central Supply Co. offering to sell a used fork lift truck for $9,000. Central Supply Co. refused the offer but made a counter-offer to City Casting Co. to purchase the fork lift truck for $8,000. City Casting Co. sent a telex in return, rejecting Central Supply Co.'s offer to purchase and offered to sell the fork lift truck for $8,200. In sending the telex, the price was mistakenly typed as $820, instead of $8,200. If Central Supply Co. should "snap up" the offer, Central Supply Co. could not enforce City Casting Co.'s promise to sell because the courts would reject the claim on the basis of the obvious error in the offer. City Casting Co., after offering the fork lift truck for sale for $9,000 and rejecting an offer for $8,000, would not then offer to sell the fork lift truck for a consideration of $820.

If the error, however, was in City Casting Co.'s original letter in which it intended to sell the fork lift truck for $9,000 but inadvertently offered it to Central Supply Co. for $8,000 and Central Supply Co. accepted the offer, it would probably be bound by the contract. In this case, the courts would have no way of determining City Casting Co.'s intention at the time the offer was made and would not inquire into the adequacy of the consideration.

To be valid, consideration must also be something of value that the person receives in return for the promise made. It cannot be something that the person has received before the promise is made, nor can it be something that a person is already entitled to receive by law or under another enforceable agreement. In the first case, if a person has already received the benefit for which the promise is offered, nothing is received in return for the promise. The consideration is essentially *past* consideration, which is no consideration at all, and the promise is gratuitous. The consideration offered must be something that the promisee will give, pay, do, or provide, either at the instant the promise is made (present consideration), or at a later date (future consideration).

In the second case, the consideration that the promisee agrees to provide in return for the promise must not be something that the promisee is already bound to do at law or under another agreement. In both instances, it would not constitute a benefit that the promisor would receive in return for the promise, and it would not constitute valuable consideration. If a person already has a duty to do some act, provide some service, or pay something to the promisor, then the promisor receives nothing from the promisee in return for the promise, other than that which he or she is already entitled to receive. There is no consideration given in return for the promise; again, the promise would be gratuitous.

EXAMPLE

Smith Home Builders Inc. entered into a contract with Jones to construct a house for her on her property for $190,000. Smith Home Builders Inc. underestimated the cost of constructing the house, and when the house was partly finished, it refused to proceed with the completion of the construction, unless Jones agreed to pay it an additional $10,000. If Jones agrees to pay the additional amount, and Smith Home Builders Inc. completes the construction, Jones is not bound by the promise if she should later decide to withhold the $10,000. The company is already under a duty to construct the house for Jones, and Jones receives nothing in return for her promise to pay the additional amount of money. Her promise is gratuitous and unenforceable by Smith Home Builders Inc.

Quite apart from the aspect of lack of consideration, the enforcement of a contract of the kind illustrated in this example would be contrary to public policy. If this type of contract were enforceable, it would open the door to extortion in the sense that an unethical contractor could threaten to cease operations at a critical stage in the construction, unless additional funds were made available to complete the remainder of the contract.

As noted earlier, the consideration in a contract must be *legal*. For example, if Able should promise Baker $10,000 if Baker will murder Charlie, and later Able fails to pay Baker the $10,000 when Charlie is murdered, the courts would not enforce Able's promise. Public policy dictates that the contract must be lawful in the sense that the promises do not violate any law or public policy. For this reason, an ordinary business contract containing a clause requiring the buyer to resell goods at a fixed or minimum price would be unlawful under the *Competition Act*. It would be illegal as well as unenforceable.

Occasionally, a person may request goods or services of another, and the goods will be provided or the services rendered without mention of the price. In effect, no mention of consideration is made. The courts, however, have determined that by requesting the goods or the service the parties had made an agreement, whereby the goods would be supplied or the service rendered in return for the implied promise of payment of a reasonable price for the goods or a reasonable price for the services rendered.

If the parties agree upon a price for the services or goods at any time after the services have been performed or the goods supplied, the agreed price will prevail, and the contract will become an agreement for a fixed price. If the parties cannot agree upon a reasonable price, then the courts will decide what is reasonable, based upon the price of the goods or the service in the area where the contract was made. As a general rule, the rate charged for similar goods or services by other suppliers of goods and services in the immediate area will be treated by the courts as a reasonable price. If the price charged for the service or goods is comparable with the "going rate" charged by similar suppliers, then the court will fix the contract price accordingly.

EXAMPLE

A homeowner may call a plumber to fix a leak in a water pipe. No price for the service call is mentioned, but the plumber responds to the call and repairs the broken pipe. The plumber later submits an account for $200 for the work done. If the homeowner considers the account excessive, then recourse may be had to the courts to have a reasonable price fixed for the work done. However, if the parties agreed upon $200 as the price at any time after the request for the service was made by the homeowner, the price of $200 would stand.

Seal as Consideration

A major exception to the requirement for consideration in a contract is a device that was used by the courts to enforce promises long before modern contract law emerged. This particular device is the use of a *seal* on a written contract. In the past, a written agreement would be enforced by the court if the promisor had placed his seal on the document. The general thinking of the judges of the day was that any person who affixed a seal to a document containing a promise to do something had given the matter considerable thought, and the act of affixing the seal symbolized the intention to be bound by the agreement. This particular method of establishing an agreement, this ritual, distinguished the formal contract from the ordinary or simple contract that may or may not be in writing. Today, most formal legal documents that require a seal either have the seal printed on the form or have a small gummed wafer attached to the form by the party who prepares the document before it is signed by the promisor. The binding effect of a formal contract under seal, however, persists today. The courts will not normally look behind a contract under seal to determine if consideration exists.

In spite of its ancient roots, the contract under seal is a useful form of contract today. For example, where parties wish to enforce a gratuitous promise, the expression of the promise in writing with the signature of the promisor and a seal affixed is the usual method used.

Many formal agreements still require a special form and execution under seal to be valid. For example, in some provinces where the Registry System applies to land transfers, the law may require a conveyance of land to be in accordance with a particular form, as well as signed, sealed, and delivered to effect the transfer of the property interest to the grantee. A power of attorney in some provinces must also be executed under seal to authorize an attorney to deal with a grantor's land.

Corporations also may use a seal containing the corporation's name to sign formal documents. It should be noted, however, that not all corporations are required to have seals. Under some business corporations' statutes (such as the *Canada Business Corporations Act*) formal documents need only be signed by the proper officers of the corporation. The general trend has been to eliminate the need for business corporations to use seals to execute such documents as contracts.

CASE LAW

A well-educated, elderly gentleman of sound mind owned a large parcel of land that he wished to enjoy until his death. However, to avoid the tax implications of leaving his property by his will, he decided to transfer the land to his favourite nephew. The nephew's lawyer prepared a declaration of gift and trust for the uncle to sign that would transfer the ownership of the property to the nephew and his wife. The uncle reviewed the documents with the lawyer but did not seek independent legal advice. He signed the documents, which had a seal affixed to the paper next to his signature.

Some time later, the uncle and nephew had a disagreement, and the uncle demanded the return of the property. The nephew and his wife, however, had transferred the property to their corporation and refused to return it. The uncle sued for the return of the property, claiming undue influence and no consideration.

The court held that gifts made by a document under seal were binding, provided that it was the intention of the party to make the gift at the time. The court concluded that the document expressed the intention of the uncle at the time of signing to make a gift of the property to his nephew and that there was no undue influence on the part of the nephew. The contract was held to be binding.

Romaine Estate v. Romaine (2001), 205 D.L.R. (4th) 320.

The Click as Consideration

While historically the Common Law recognizes "even a peppercorn" as being sufficient valuable consideration to bind a contract, and the seal has been the substitute, we are now faced with the question of whether a mouse click is an acceptable equivalent. Indeed, some Web sites attract hits by offering a benefit to consumers (a prize, discounted merchandise, etc.) in return for the willingness of the browsing party to click through the site and at least be exposed to banner advertising. The sale of these banners to advertisers is the prime source of the site's revenue, balanced against the cost of prizes or discounts given to consumers.

It seems sensible that a click should at least be equivalent to the application of a seal, but it hardly retains the gravity of a deliberate act that a wax seal and signet ring once represented. Who can remember how many times they clicked on a computer screen yesterday, or in the past week? The click will become the new seal when it is tested in court by the first party who attempts to enforce a promised, but undelivered, Internet-based benefit.

Tenders

Tender
The act of performing a contract or the offer of payment of money due under a contract.

The **tender** in contract law, as it relates to the formation of a legal relationship, differs from the ordinary offer. Tenders are frequently used by business firms, government organizations, and others with a view to establishing a contractual relationship for the supply of goods or services or the construction of buildings, machinery, or equipment. Municipalities commonly use the tender method to obtain supplies or services as a means of fairly opening competition to all firms in the municipality (and elsewhere). The tendering process generally uses the seal to render an offer irrevocable and often uses the payment of a money deposit as a special type of consideration.

The tender process usually involves the advertisement of the needs of the firm to potential suppliers of the goods or services, either by way of newspapers or by direct mail contact. This step in the process is known as *calling for tenders* and has no binding effect on the firm that makes the call. It is merely an offer to negotiate a contract. In most cases, it represents an

invitation to persons or business firms to submit offers that the firm calling for the tenders may, at its option, accept or reject. The firm making the call is not bound to accept the lowest offer or, for that matter, any of the offers.

As a general rule, unless provided to the contrary in the call for tenders, an offer made in response to the call may be revoked at any time before acceptance. To avoid this, the call for tenders frequently requires offerors to submit their offers as irrevocable offers under seal. In this manner, the offer may not be revoked and will stand until such time as it either is accepted or expires. Businesses and organizations calling for tenders may also require the offerors to provide a money deposit as well to ensure that the successful offeror will execute the written contract that is usually required to formalize the agreement between the parties. When a deposit has been submitted with the tender under seal, a failure or refusal on the part of the successful bidder to enter into the formal contract and perform it according to its terms would result in forfeiture of the deposit and entitle the party who made the call to take legal action as well. For example, in the case of *The Queen in Right of Ontario v. Ron Engineering and Construction Eastern Ltd.*[5] A call for tenders was made and the defendant submitted a tender along with the required deposit. Later, the defendant was notified that it was the successful bidder. The defendant, however, discovered an error in the tender that would result in a loss for the defendant if the contract was performed. The defendant then refused to enter into a formal contract to perform the work. In the litigation that followed, the court held that the call for tenders stipulated that the deposit would be forfeited if the successful bidder refused to execute the formal contract. The defendant had agreed to these terms, and as a result, the defendant was not entitled to a return of the deposit money.

CASE LAW

The government of Canada leased a building from a corporation under a lease for a period of years. As the lease was about to expire, the parties entered into negotiations for its renewal but could not agree on the cost of certain renovations and the cost of a security system. The government then advertised for tenders, and the corporation put in a bid offering the same space, including the cost of renovations and the cost of a security system. A competitor entered a similar but lower bid which did not include security system costs and was the successful bidder.

The tender advertisement did not include a security system and stated that the government was not obliged to accept the lowest or any bid. The corporation took legal action against the government on the basis that it had a duty to treat all bidders fairly and a duty of care in its negotiations.

The Supreme Court of Canada dismissed the corporation's claim on the basis that the government, in preparing its tender documents, could decide which renovations it required and had treated both competitors equally, particularly since the accepted bid was the lower of the two, even with the security system costs included in the corporation's bid.

Martel Building Ltd. v. Canada (2001), 193 D.L.R. (4th) 1.

3.6 THE DEBTOR–CREDITOR RELATIONSHIP

Under the law of contract, a debt paid when due ends the debtor–creditor relationship, as the debtor has fully satisfied his or her obligations under the contract. Similarly, the creditor has no

5 *The Queen in Right of Ontario v. Ron Engineering and Construction Eastern Ltd.* (1981), 110 D.L.R. (3d) 267.

rights under the contract once the creditor has received payment in full. In many cases, however, the debtor and creditor may agree that the amount payable on the due date should be less than the full amount actually due. At first glance, it would appear that this common business practice is perfectly proper. The creditor should be free to accept a lesser sum than the amount due, and one might expect the promise to be binding. Unfortunately, this practice runs counter to the doctrine of consideration. Unless the parties bring themselves within an exception to this rule, the creditor's promise is simply gratuitous and unenforceable.

Under the doctrine of consideration, where a creditor agrees to accept a lesser sum than the full amount of the debt on the due date, there is no consideration for the creditor's promise to waive payment of the balance of the debt owed. To recover this amount, the creditor can, if he so desires, sue for payment of the balance immediately after receiving payment of the lesser sum.

The difficulties that the application of this principle raise for the business community are many, and the courts, as a result, have attempted to lessen the impact or harshness of the law in a number of ways. The most obvious method of avoiding the problem of lack of consideration would be for the parties to include the promise to take a lesser sum in a written document that would be under seal and signed by the creditor. The formal document under seal would eliminate the problem of lack of consideration entirely. A second method would be for the creditor to accept something other than money in full satisfaction of the debt. For example, the debtor could give the creditor his automobile or truck as payment in full, and the courts would not inquire into the adequacy of the consideration. Payment of the lesser sum in full satisfaction of the debt *before the due* date would also be consideration for the creditor's promise to forgo the balance, since the payment before the time required for payment would represent a benefit received by the creditor. A final exception to the consideration rule arises where the lesser sum is accepted as payment in full by the creditor from a third party who makes the payment in settlement of the creditor's claim against the debtor.

EXAMPLE

Able is indebted to Big City Finance for $5,000. Charlie, Able's father, offers Big City Finance $4,000 as payment in full of his son's indebtedness. If Big City Finance accepts Charlie's payment as settlement of the $5,000, it cannot later sue Able for the remaining $1,000, as it would be a fraud on the stranger (Charlie) to do so.

The difficulties that this particular rule for consideration raises in cases where indebtedness has been gratuitously reduced have been resolved, in part, by legislation in most jurisdictions. In all provinces west of Quebec, statute law (such as the *Mercantile Law Amendment Act*[6] in Ontario) provides that a creditor who accepts a lesser sum in full satisfaction of a debt will not be permitted to later claim the balance once the lesser sum has been paid. The eastern Common Law provinces, however, remain subject to the requirement of consideration, and the parties must follow one of the previously mentioned methods of establishing or avoiding consideration, if the debtor is to avoid a later claim by the creditor for the balance of the debt.

The relationship between an individual creditor and debtor, however, must be distinguished from an arrangement or a *bona fide* scheme of consolidation of debts between a debtor and his or her creditors. This differs from the isolated transaction in that the creditors agree with each other to accept less than the full amount due them. Each of the creditors promise the other

6 *Mercantile Law Amendment Act*, R.S.O. 1990, c. M-10.

creditors to forgo a portion of the claim against the debtor (and forbear from taking legal action against the debtor to collect the outstanding amount) as consideration for their promise to do likewise.

It is also important to note that an agreement between a creditor and debtor, whereby the creditor agrees to accept a lesser sum when the amount owed is in dispute, does not run afoul of the consideration rule. If there is a genuine dispute concerning the amount owed and the creditor accepts a sum less than the full amount claimed, the consideration that the creditor receives for relinquishing the right to take action for the balance is the debtor's payment of a sum that the debtor honestly believes he does not owe the creditor.

3.7 GRATUITOUS PROMISES CAUSING INJURY TO ANOTHER: EQUITABLE OR PROMISSORY ESTOPPEL

A gratuitous promise is, by definition, a promise that the promisor has no legal obligation to perform. Occasionally, when the recipient of such a promise relies on the promise to his or her detriment, the following social question arises: Should the promisor, having misled the promisee, be required to compensate the promisee for his or her loss? After all, it was the promisor's promise that induced the promisee to act to his or her detriment.

It is a settled point of law that once a fact is asserted to be true (even if it is later proved otherwise) and another person relies on it to his or her detriment, that statement of fact cannot be denied by the person who made the assertion. This particular concept is known as **estoppel**. The essential characteristics of estoppel are the expression of a fact as being true and the reliance on that statement by the other party.

Estoppel
A rule whereby a person may not deny the truth of a statement of fact made by him or her when another person has relied and acted upon the statement.

EXAMPLE

A developer owned an apartment building and leased the entire building under a 30-year lease to a corporation that was prepared to manage the building and lease out all apartment units to individual tenants. A few years later, major city reconstruction of the roads and the demolition of adjoining buildings as a part of the city redevelopment of the area made the leasing of apartments in the building impossible for the management corporation. The developer agreed to reduce the rent of the building by 25 percent while the redevelopment of the area took place. The redevelopment took two years to be completed, and at that point, the regular rent of the building resumed. The developer, however, demanded the back-payment of the 25-percent reduction for the two-year period as well.

In this case, the management relied on the promise of the developer of the 25-percent rent reduction and rented apartments during the redevelopment accordingly. The defence of estoppel to the 25-percent rent claim would probably be a good defence to any claim for payment by the developer.

In contract relationships, its use has continued as an effective defence against a claim relating to the enforcement of contractual rights where the promisee has relied upon a gratuitous promise to his or her detriment.

LEARNING GOALS REVIEW

- Consideration is required in a contract unless the contract is made under seal.
- Consideration may be present or future, but it cannot be past consideration.
- Consideration must have some value in the eyes of the law.
- Gratuitous reduction of a debt at Common Law requires something of value given, payment before the due date, or a third-party payment.
- Estoppel may be a defence if a party relies, to his or her detriment, on the gratuitous promise of another.

3.8 CAPACITY TO CONTRACT

Capacity
The ability at law to bind a person in contract.

Not everyone is permitted to enter into contracts that would bind them at law. Certain classes of promisors must be protected as a matter of public policy, either for reasons of their inexperience and immaturity or due to their inability to appreciate the nature of their acts in making enforceable promises.

Minors

The most obvious class to be protected is the group of persons of tender age called minors. A minor at Common Law is a person under the age of 21 years, but in most provinces, this has been lowered to 18 or 19 years of age by legislation.

Minors, nevertheless, represent a significant and highly desirable segment of the commercial marketplace with a buying power due to their parental support. Thus, business seeks their commercial activity but must be aware of the unique dangers of dealing with this segment of the market.

Public policy dictates that minors should not be bound by their promises, and consequently, they are not liable on most contracts that they might negotiate. The rule is not absolute, however, because in many cases, a hard-and-fast rule on the liability of a minor would not be in his or her best interests. For example, if a minor could not incur liability on a contract for food or clothing, the hardship would fall on the minor, rather than on the party with full power to contract, as no one would be willing to supply a minor with food, shelter, or clothing on credit. The law, therefore, attempts to balance the protection of the minor with the need to contract by making only those contracts for necessary items enforceable against a minor.

Necessaries and Repudiation

A minor of tender age is normally under the supervision of a parent or guardian, and the need to contract in the minor's own name is limited. The older minor, however, is in a slightly different position, with a need in some cases to enter into contracts for food, clothing, shelter, and other necessaries, including student loans. For this latter group, the law provides that a minor will be bound by contract for necessaries and will be liable for a reasonable price for the goods received or the services supplied. The effect of this rule is to permit a merchant to provide necessaries to

a minor yet limit the minor's liability to a reasonable price. This is eminently fair to both contracting parties: The merchant is protected because the minor is liable on the contract; the minor is protect in that the merchant may only charge the minor a reasonable price for the goods.

The general rule relating to contracts that have not been fully performed for non-necessary goods or services is that the minor may repudiate the contract at any time at his or her option. This rule applies even when the terms of the contract are very fair to the minor. Once the contract has been repudiated, the minor is entitled to a return of any deposit paid to the adult contractor. However, where the minor has purchased the goods on credit and taken delivery, the minor must return the goods before the merchant is obliged to return any monies paid. Any damage to the goods that is not a direct result of the minor's deliberate act is not recoverable by the merchant; the merchant may not deduct the "wear and tear" to the goods from the funds repayable to the minor.

Minors who enter into long-term contracts of a continuing nature must repudiate them promptly on reaching the age of majority, otherwise they will be bound by them.

Contracts for non-necessary items purchased that are not of a continuing nature by a minor must be ratified (acknowledged and agreed to perform) by the minor on attaining the age of majority in order to be bound by the agreement.

The provinces of New Brunswick, Newfoundland, Nova Scotia, Prince Edward Island, and Ontario have modified the Common Law by requiring the ratification of a contract in writing before it becomes binding on the minor. British Columbia legislation makes all contracts with minors unenforceable during the period of minority but permits ratification after the minor reaches the age of majority.

Drunken and Mentally Impaired Persons

The courts treat drunken and mentally impaired persons in much the same way as minors with respect to their capacity to contract. Those persons who have been committed to a mental institution cannot normally incur any liability in contract, and persons who suffer mental impairment from time to time are subject to a number of special contract rules.

In general, persons who suffer from a mental disability, such as Alzheimer's disease, or some mental impairment caused either as a result of some physical or mental damage or as a result of drugs or alcohol will be liable on any contract for necessaries negotiated by them, and they will be obliged to pay a reasonable price for the goods or services. In this respect, the law makes no distinction between minors and persons suffering from some mental disability. The merchant involved would be entitled to payment, even if the merchant knew of the mental or drunken state of the purchaser. Again, public policy dictates that it is in the best interests of the drunken or mentally impaired person to be entitled to obtain the necessaries of life from merchants and to be bound by such contracts of purchase.

Contracts for non-necessary items, however, are treated in a different manner from contracts for necessaries. If a person is intoxicated or mentally impaired when entering into a contract for what might be considered a non-necessary item or service, and the person's mental state renders him incapable of knowing or appreciating the nature of his actions (and if he can establish by evidence that he was in such a condition and the other contracting party knew he was in that condition), then the contract may be voidable by him when he becomes aware of the contract upon his return to a sane or sober state.

It is important in the case of an intoxicated or mentally impaired person that the contract be repudiated as soon as it is brought to the person's attention after his or her return to sanity or sobriety. If the contract is not repudiated promptly and all of the purchased goods returned, the

opportunity to avoid liability will be lost. Similarly, any act that would imply acceptance of the contract while sane or sober would render the contract binding.

EXAMPLE

Hendrick attended an auction sale while in an intoxicated state. Everyone at the sale, including the auctioneer, was aware of his condition. When a house and land came up for auction, Hendrick bid vigorously on the property and was the successful bidder. Later, when in a sober state, he was informed of his purchase, and he affirmed the contract. Immediately thereafter, he changed his mind. He repudiated the contract on the basis that he was drunk at the time and that the auctioneer was aware of his condition.

When the case came before the court, the court held that he had had the opportunity to avoid the contract when he became sober, but instead, he affirmed it. Having done so, he was bound by his acceptance, and he could not later repudiate the contract.

Corporations

A corporation is a creature of statute and, as such, may possess only those powers that the statute may grant it. Corporations formed under Royal Charter or letters patent are generally considered to have all the powers to contract that a natural person may have. The statute that provides for incorporation may specifically give the corporation these rights as well. The legislature need not give a corporation broad powers of contract if it does not wish to do so; indeed, many special-purpose corporations do have their powers strictly controlled or limited. Many of these corporations are created under a special act of a legislature or Parliament for specific purposes. If they should enter into a contract that is beyond their limitations, the contract will be void. While this may appear to be harsh treatment for an unsuspecting person who enters into a contract with a "special act" corporation that acts beyond the limits of its powers, everyone is deemed to know the law, and the statute creating the corporation and its contents, including the limitations on its contractual powers are considered to be public knowledge and available to everyone.

Business corporations in most provinces are usually incorporated under legislation that gives the corporations very wide powers to contract and, in many cases, all the power of a mature natural person. This is not, however, always the case. A corporation, in its articles of incorporation, may limit its own powers for specific reasons, and depending upon the legislation under which it was incorporated, the limitation may bind third parties. A full discussion of the effect of these limitations on the capacity of a corporation to contract is covered later in the text.

Labour Unions

An agreement that a labour union negotiates with an employer would not normally be enforceable were it not for specific legislation governing its negotiation and enforcement. The legislation in most provinces and at the federal level provides for the interpretation and enforcement of collective agreements by binding arbitration, rather than the courts. In addition, the legislation in all provinces specifically provides that a labour union certified by the Labour Relations Board has the exclusive authority to negotiate a collective agreement for the employees it represents. The capacity of a labour union in this regard is examined in detail in the employment law chapter of the text.

Bankrupt Persons

A person who has been declared bankrupt has a limited capacity to contract. Until a bankrupt person receives a discharge, he or she may not enter into any contract except for necessaries. All business contracts entered into before bankruptcy become the responsibility of the trustee in bankruptcy, and the bankrupt, on discharge, is released from the responsibility of the contracts and all related debts, except those relating to breach of trust, fraud, and certain orders of the court. To protect persons who may not realize that they are dealing with an undischarged bankrupt, the *Bankruptcy and Insolvency Act*[7] requires the undischarged bankrupt to reveal the fact that he or she is an undischarged bankrupt before entering into any contract involving more than $500.

3.9 ENFORCEABILITY OF AN ILLEGAL AGREEMENT

The Requirement of Legality

Agreements that offend the public good are not enforceable. If parties enter into an agreement that has an illegal purpose, it may not only be unenforceable but illegal as well. Under these circumstances, the parties may be liable to a penalty or fine for either making the agreement or attempting to carry it out. An illegal contract, if considered in a narrow sense, includes any agreement to commit a crime, such as an agreement to rob, obtain goods under false pretenses, or commit any other act prohibited under the *Criminal Code of Canada*.[8] For example, an agreement by two parties to rob a bank would be an illegal contract and subject to criminal penalties as a conspiracy to commit a crime, even if the robbery were not carried out. If one party refused to go through with the agreement, the other party would not be entitled to take the matter to the courts for redress because the contract would be unenforceable.

Another type of agreement that would be unenforceable would be an agreement relating to the embezzlement of funds by an employee where the employee, when the crime is discovered, promises the employer restitution in return for a promise not to report the crime to the police. The victim of the theft is often not aware that the formation of an agreement to accept repayment of the funds in return for a promise to not report the crime is improper. The contract would accordingly be unenforceable.

A statute that affects certain kinds of contracts that is part criminal law, is the federal *Competition Act*.[9] This statute renders illegal any contract or agreement between business firms that represents a restraint of competition. The *Act* covers a number of business practices that are contrary to the public interest, the most important being contracts or agreements to fix prices, eliminate or reduce the number of competitors, allocate markets, or reduce output in such a way that competition is unduly restricted. The *Act* applies to contracts concerning both goods and services, and it attempts to provide a balance between freedom of trade and the protection of the consumer. The formation of mergers or monopolies that would be against the public interest may also be prohibited under the *Act*, and all contracts relating to the formation of such a new entity would be unenforceable. Any agreement between existing competitors that would prevent new competition from entering the market would be prohibited by the *Act*, and the agreement would be illegal.

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7 *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended by S.C. 1992, c. 27.
8 *Criminal Code of Canada*, R.S.C. 1985, c. C-46.
9 *Competition Act*, R.S.C. 1985, c. C-34.

Statute law, other than criminal law, may also render certain types of contracts illegal and unenforceable. Some statutes (such as worker's compensation legislation, land-use planning legislation in some provinces, and wagering laws) render any agreement made in violation of the *Act* void and unenforceable. In contrast to illegal contracts, void contracts usually carry no criminal penalties with them. The contract is simply considered to be one that does not create rights that may be enforced.

EXAMPLE

Under the land use control legislation in Ontario,[10] any deed to convey a part of a lot that a landowner owns that requires the consent of the planning authority for the severance, is void, unless consent to sever the parcel is obtained from the planning authority and endorsed on the deed.

With respect to gambling, the courts have long frowned upon gamblers using the courts to collect wagers and, as a matter of policy, have treated wagering contracts as unenforceable, except where specific legislation has made them enforceable.

Unlicensed Tradespersons

One type of contract that the courts treat as illegal is a contract between an unlicensed tradesperson or professional and a contracting party. If the jurisdiction in which the tradesperson or professional operates requires the person to be licensed in order to perform services for the public at large, then an unlicensed tradesperson or professional may not enforce a contract for payment for the services if the other party refuses to pay the account. In most provinces, the licensing of professionals is on a province-wide basis, and penalties are provided where an unlicensed person engages in a recognized professional activity. The medical, legal, dental, land surveying, architectural, and engineering professions, for example, are subject to such licensing requirements in an effort to protect the public from unqualified practitioners. The same holds true for many trades, although in some provinces, these are licensed at the local level.

Where a licence to practise is required and the tradesperson is unlicensed, it would appear to be a good defence to a claim for payment for the defendant to argue that the contract is unenforceable on the tradesperson's part because he or she is unlicensed. However, where the unlicensed tradesperson supplies materials as well as services, the defence may well be limited only to the services supplied and not to the value of the goods. In a 1979 case,[11] a provincial supreme court held that an unlicensed tradesperson may recover for the value of the goods supplied because the particular by-law licensing the contractor did not contain a prohibition on the sale of material by an unlicensed contractor. It should be noted, however, that the reverse does not apply. If the tradesperson fails to perform the contract properly and the injured party brings an action against the tradesperson for breach of contract, the tradesperson cannot claim that the contract is unenforceable because he or she does not possess a licence. The courts will hold the tradesperson liable for the damages that the other party suffered.

10 The *Planning Act*, R.S.O. 1990, c. P-13, s. 49, provides that any subdivision and sale of land that violates the *Act* is void in the sense that no property interest passes.

11 *Monticchio v. Torcema Construction Ltd.* (1979), 26 O.R. (2d) 305.

BUSINESS LAW IN PRACTICE MANAGING RISK

Homeowners who engage the services of unlicensed tradespeople to perform home renovations (such as electrical or plumbing work) assume much of the risk if the work is negligently done and damage occurs. Insurers may, for example, be reluctant to pay for fire damage due to negligent installation of wiring, if their policies require electrical renovations or changes to be performed only by licensed tradespeople. A homeowner's rights at law against an unlicensed tradesperson for the ensuing loss may be of little practical value if the tradesperson has few, if any, assets.

Public Policy Prohibitions

There are a number of different circumstances at Common Law under which a contract will not be enforceable. Historically, these are activities that were contrary to public policy and remain so today. "Public policy" can be defined as the bundle of rules that protect the interests of society, and the category of activities that offend public policy are those likely to impair the integrity of our markets, corrupt governance, or breed injustice. Contracts designed to obstruct justice, injure the public service, or injure the state are clearly not in the best interests of the public. They are illegal as well as unenforceable. An agreement, for example, that is designed to stifle prosecution or influence the evidence presented in a court of law is contrary to public policy.

Public policy and the *Criminal Code* also dictate that any contract that tends to interfere with or injure the public service would be void and illegal. For example, an agreement with a public official whereby the official would use his or her position to obtain a benefit for the other party in return for payment would be both illegal and unenforceable.

Another class of contract that would be contrary to public policy is a contract involving the commission of a tort or a dishonest or immoral act. In general, agreements of this nature that encourage or induce others to engage in an act of dishonesty or immoral conduct will be unenforceable.

Contracts for debts where the interest rate charged by the lender is unconscionable are contrary to public policy. Where a lender attempts to recover the exorbitant interest from a defaulting debtor, the courts will not enforce the contract according to its terms but may set aside the interest payable or, in some cases, order the creditor to repay a portion of the excessive interest to the debtor.

The law with respect to contracts of this nature is not clear as to what constitutes an unconscionably high rate, as there is often no fixed statutory limit for contracts where this issue may arise. Interest rates fall within the jurisdiction of the federal government, and while it has passed a number of laws controlling interest rates for different types of loans, the parties, in many cases, are free to set their own rates. To prevent the lender from hiding the actual interest rate in the form of extra charges, consumer protection legislation now requires disclosure of true interest rates and the cost of borrowing for many kinds of consumer loan transactions. For others, the courts generally use, as a test, the rate of interest that a borrower in similar circumstances (and with a similar risk facing the lender) might obtain elsewhere. To charge an interest rate in excess of 60 percent would violate the *Criminal Code* and render the creditor liable to criminal action as well.

CASE LAW

A trucking company entered into a complex borrowing agreement with a financial corporation for its business financing and the buy-out of certain shareholders, which included royalty payments, monthly monitoring fees, legal and administration fees, and a commitment fee, as well as a monthly interest rate of 4 percent. Shortly thereafter, the parties revised the agreement, but it remained as an agreement that would call for an interest rate of 4 percent per month and administrative and other fees of approximately 31 percent. Both parties agreed that they did not intend to act illegally, but the interest rate exceeded the 60 percent limit imposed by the *Criminal Code*, as an interest rate of 4 percent per month exceeded the *Criminal Code* limit by 0.1 percent, calculated on an annual basis.

The borrower applied to the court for a declaration that the agreement was void and illegal. The case eventually went to the court of appeal, where the court held that the provision in the agreement that provided for an interest rate of 4 percent per month was void and struck it from the agreement, with the rest of the agreement remaining enforceable.

Transport North American Express Inc. v. New Solutions Financial Corporation (2002), 214 D.L.R. (4th) 44.

3.10 CONTRACTS IN RESTRAINT OF TRADE

Restraint of trade
Illegal acts which impair the operation of the marketplace.

Contracts in **restraint of trade** fall into three categories:

1. Agreements contrary to the *Competition Act* (which were briefly explained earlier in this chapter).
2. Agreements between the vendor and purchasers of a business that may contain an undue or unreasonable restriction on the right of the vendor to engage in a similar business in competition with the purchaser.
3. Agreements between an employer and an employee that unduly or unreasonably restrict the right of the employee to compete with the employer after the employment relationship is terminated.

Of these three, the last two are subject to the Common Law public policy rules that determine their enforceability. The general rule, in this respect, states that all contracts in restraint of trade are void and unenforceable because they offend public policy. The courts will, however, enforce some contracts of this nature, if it can be shown that the restraint is both reasonable and necessary and does not offend the public interest.

Restrictive Agreements Concerning the Sale of a Business

When a vendor sells a business that has been in existence for some time, the goodwill that the vendor has developed is a part of what the purchaser acquires. Since goodwill is something that is associated with the good name of the vendor and represents the likelihood of customers returning to the same location to do business, its value will depend in no small part on the vendor's intentions when the sale is completed. If the vendor intends to set up a similar business in the immediate vicinity of the old business, the "goodwill," which the vendor has developed will probably move with the vendor to the new location. The purchaser, in such a case, would acquire little more in the sale than a location and some goods. The purchaser would not acquire many of the vendor's old customers and, consequently, may not value the business at more than

the cost of stock and the premises. On the other hand, if the vendor is prepared to promise the purchaser that he or she will not establish a new business in the vicinity or engage in any business in direct competition with the purchaser of the business, the goodwill of the business will have some value to both parties. The value, however, is in the enforceability of the promise of the vendor not to compete or do anything to induce the customers to move their business dealings from the purchaser after the business is sold.

The difficulty with the promise of the vendor is that it is a restraint of trade. The courts, however, recognize the mutual advantage of such a promise with respect to the sale of a business. If the purchaser can convince the court that the restriction is reasonable and does not adversely affect the public interest, then the restriction will be enforced. It is important to note, however, that the court will not rewrite an unreasonable restriction to render it reasonable. It will only enforce a reasonable restriction and nothing less.

Unreasonableness

The danger that exists with restrictions of this nature is the temptation on the part of the purchaser to make the restriction much broader than necessary to protect the goodwill. If care is not taken in the drafting of the restriction, it may prove to be unreasonable and will then be struck down by the court. If this should occur, the result will be a complete loss of protection for the purchaser, as the court will not modify the restriction to make it enforceable. For example, the owner operates a drugstore in a small town and enters into a contract with a purchaser whereby the purchaser will purchase the business if the owner will promise not to carry on the operation of a drug store within a radius of 160 km of the existing store for a period of 30 years.

In this case, the geographical restrictions would be unreasonable. The customers of the store, due to the nature of the business, would be persons living within the limits of the town and perhaps within a few kilometres radius. No substantial number of customers would likely live beyond a 10-km radius. Similarly, the time limitation would be unreasonable, as a few years would probably be adequate for the purchaser to establish a relationship with the customers of the vendor. The courts, in this instance, would probably declare the restriction unenforceable; and with the restriction removed, the vendor would be free to set up a similar business in the immediate area if he or she wished to do so.

Agreements of this nature might be severed if a part of the restriction is reasonable and a part overly restrictive. In a classic case on this issue, a manufacturer of arms and ammunition transferred his business to a limited company. As a part of the transaction, he promised that he would not work in or carry on any other business manufacturing guns and ammunition (subject to certain exceptions) or engage in any other business that might compete in any way with the purchaser's business for a period of 25 years. The restrictions applied on a worldwide basis. The court, in this case, recognized the global nature of the business and held that the restriction preventing the vendor from competing in the arms and ammunition business anywhere in the world was reasonable and the restriction enforceable. However, it viewed the second part of the restriction (which prevented the vendor from engaging in any other business) as overly restrictive. The court severed it from the contract on the basis that the two promises were separate.

Restrictive Agreements between Employees and Employers

The law distinguishes restrictive agreements concerning the sale of a business from restrictive agreements made between an employer and an employee. In the latter case, an employer, in an attempt to protect business practices and business secrets, may require an employee to promise not to compete with the employer upon termination of employment. The legality of this type of

restriction, however, is generally subject to close scrutiny by the courts, and the criteria applied differ from that which the law has established for contracts where a sale of a business is concerned.

The justification for the different criteria is based upon the serious consequences that may flow from a restriction of the employee's opportunities to obtain other employment and to exercise acquired skills or knowledge. In general, the courts do not wish to place any limits on a person seeking employment. As a consequence, a **restrictive covenant** in a contract of employment will not be enforced, unless serious injury to the employer can be clearly demonstrated. This reluctance of the courts stems from the nature of the bargaining relationship at the time the agreement is negotiated between the employer and the employee. The employee is seldom in a strong bargaining position vis-a-vis the employer when the employment relationship is established. Also, the employment contract is often an agreement on the employer's standard form that the employee must accept or reject at the time. Public policy recognizes the unequal bargaining power of the parties by placing the economic freedom of the employee above that of the special interests of the employer.

Restrictive covenant
Contractual term limiting the rights or actions of a party, often beyond the life of the contract.

In some cases, however, the special interests of the employer may be protected by a restrictive covenant in a contract of employment. The courts have held, for example, that when an employee has access to secret production processes of the employer, the employee may be restrained from revealing this information to others after the employment relationship is terminated. The same view is taken where the employee has acted on behalf of the employer in his or her dealings with customers and later uses the employer's customer lists to solicit business for a new employer. The courts will not, however, prevent an employee from soliciting business from a previous employer's customers under ordinary circumstances, nor will the courts enforce a restriction that would prevent a person from exercising existing skills and ordinary production practices acquired while in the employment relationship after the relationship is terminated.

In contrast, contracts of employment containing restrictions on the right of employees to engage in activities or business in competition with their employer while the employment relationship exists are usually enforceable. This is provided that they do not unnecessarily encroach on the employees' personal freedom and that they are reasonable and necessary. The usual type of clause of this nature is a "devotion to business" clause in which the employees promise to devote their time and energy to the promotion of the employer's business interests and to refrain from engaging in any business activity that might conflict with it.

Confidentiality Requirements

A second type of restriction sometimes imposed by an employer is one requiring the employee to keep confidential any information of a confidential nature concerning the employer's business that might come into the employee's possession as a result of the employment. An employee subject to such a covenant may be liable for breach of the employment contract (and damages) if he or she should reveal confidential information to a competitor that results in injury or damage to the employer. Restrictions of this type are frequently written to extend beyond the termination of the employment relationship, and if reasonable and necessary, they may be enforced by the courts. The particular reasoning behind the enforcement of these clauses is not based upon restraint of trade but, rather, upon the duties of the employee in the employment relationship. The employer has a right to expect some degree of loyalty and devotion on the employee's part in return for the compensation paid to the employee. Actions on the part of the employee that cause injury to the employer represent a breach of the employment relationship, rather than a restraint of trade. It is usually only when the actual employment relationship ceases that the public policy concerns of the court come into play with respect to restrictive covenants.

CASE LAW

Reliable Toy Co., a manufacturer of plastic toys, hired Collins as chief chemist for its laboratory to work in the development of plastics for products. As a part of the hiring, Collins agreed to keep secret all of the confidential information of the company, as he would have access to the trade secrets and the secret processes that the company used in its production processes. Collins signed a written employment agreement that contained his promise to keep confidential during and after his employment all of the information concerning the secret processes. Several years later, Collins was terminated. The company later discovered that Collins had revealed one of its secret processes to a competitor and brought an action for damages and an injunction against Collins for breach of the employment agreement.

The court held that while restrictions on employees are normally void, as they are in restraint of trade, an employer may impose and enforce reasonable restrictions on employees who have access to confidential information of the employer that would seriously harm the employer if revealed to others. In this case, the court found that Collins had violated the agreement with respect to one of the manufacturer's processes and awarded damages against Collins as well as an injunction restricting Collins from revealing information about the secret process.

Reliable Toy Co. Ltd. and Reliable Plastics Co. Ltd. v. Collins, [1950] D.L.R. 499.

Defence of Public Good

With some types of employment, where the service offered to the public by the employer is essential for the public good, the courts will generally take into consideration the potential injury to the public-at-large if a restrictive covenant in an employment contract is enforced. For example, if a medical clinic employs a medical specialist under a contract of employment prohibiting the specialist from practising medicine within a specified geographic area should the specialist leave the employ of the employer, the courts might refuse to enforce the restriction, even if it is reasonable, if the court concluded that enforcement would deprive the community of an essential medical service.

BUSINESS ETHICS

Employees are frequently employed by corporations to do product development that is confidential in nature and important to the long-term success of the corporation. For this reason, employees are often required to sign confidentiality agreements whereby the employee promises not to disclose any confidential information about the employer's business.

If a competitor should offer a position to the employee and the employee moves to the competitor's firm, would it be ethical for the competitor to ask the employee to develop products similar to those under development at his or her former employer?

3.11 PRIVACY LEGISLATION

While not strictly a contract formation issue, business persons will gather considerable quantities of personal information about the person with whom they are creating a contract. This information must be gathered and maintained (at least) according to PIPEDA, the federal

government's *Personal Information Protection and Electronic Documents Act*.[12] Provincial acts may require even higher standards of accountability.

One goal of the PIPEDA was to ensure effective alternatives to paper documents for all manner of modern government operations—information, filings, payments, secure signatures, and submissions of evidence. Secondly, on the personal information side, the *Act* requires essentially all private sector enterprises and health care providers to obtain the consent of individuals to collect, use, or disclose personal information for commercial activity or health care. Further, such information must only be used for the pre-identified purposes for which it was collected, and organizations are legally liable for maintaining privacy and control over that personal data.

The PIPEDA applies across Canada as a federal act, where a province does not enact federally-approved substantially similar legislation of its own. The provincial electronic business acts have tended to separate[13] out the twin goals of privacy and commercial certainty in new technological media. It is essential for business to comply with the requirements of PIPEDA (or its provincial counterparts), not only just to obey the law, but to meet the expectations of clients. With the ever-present threat of identity theft, businesses who do not secure their client's data will find themselves liable for their failures.

Checklist of PIPEDA Compliance Requirements for Business

1. **Accountability** – An organization is responsible for personal information (PI) under its control and shall designate an individual(s) accountable for the compliance.
2. **Identifying Purposes** – The purposes for which PI is collected shall be identified and documented at or before the time the information is collected.
3. **Consent** – The knowledge and consent of the individual are required for the collection, use, or disclosure of PI, except where inappropriate (with high standards for disclosure) and subject to withdrawal of consent.
4. **Limiting Collection** – The collection of PI shall be limited to that which is necessary for the purposes identified by the organization. Information shall be collected by fair and lawful means.
5. **Limiting Use, Disclosure, and Retention** – PI shall not be used or disclosed for purposes other than those for which it was collected, except with the consent of the individual or as required by law. PI shall be retained only as long as necessary for the fulfilment of those purposes.
6. **Accuracy** – PI shall be as accurate, complete, and up-to-date as is necessary for the purposes for which it is to be used.
7. **Safeguards** – PI shall be protected by security safeguards appropriate to the sensitivity of the information.
8. **Openness** – An organization shall make readily available to individuals specific information about its policies and practices relating to the management of PI.

12 S.C. 2000, c.C-6.

13 With some jurisdictions using two separate *Acts*.

9. **Individual Access** – Upon request, an individual shall be informed of the existence, use, and disclosure of his or her PI and shall be given access to that information. An individual shall be able to challenge the accuracy and completeness of the information and have it amended as appropriate.
10. **Challenging Compliance** – An individual shall be able to address a challenge concerning compliance with the above principles to the designated individual(s) responsible for compliance.

LEARNING GOALS REVIEW

- Minors at Common Law may not be bound in contract for non-necessary purchases.
- Drunken persons and mentally impaired persons may, under certain circumstances, not be bound in contract for non-necessary purchases.
- Statutory provisions in some provinces govern the capacity of minors to contract.
- Corporations, labour unions and bankrupt persons under certain circumstances may have limited capacity to contract.
- Every contract must be legal to be binding.
- Contracts in restraint of trade are void.
- Privacy requirements apply to the collection and maintenance of customers' personal data.

SUMMARY

- The creation of an enforceable contract requires the parties to have an intention to create a legal relationship.
- A contract also requires a valid offer and acceptance of the offer as well as some form of consideration (or a seal) to be present.
- Not everyone may enter into an enforceable contract as minors, drunken persons, and persons with mental impairment may only be bound by contracts for necessaries and are subject to special contract rules as to the enforceability of contracts against them.
- The subject mater of the contract must also be legal, and if a contract is contrary to public policy, the courts may render it unenforceable.
- Certain contracts must also be in writing to be enforceable, but the courts have established a number of principles, doctrines, or rules that will permit these contracts to be enforced.

KEY TERMS

acceptance ... *p. 67*
capacity ... *p. 83*
consideration ... *p. 75*
contract ... *p. 63*
counter-offer ... *p. 69*
estoppel ... *p. 82*
gratuitous ... *p. 75*
invitation to do business ... *p. 65*
lapse ... *p. 73*

offer ... *p. 66*
offeree ... *p. 66*
offeror ... *p. 66*
option ... *p. 74*
presumption at law ... *p. 64*
restraint of trade ... *p. 89*
restrictive covenant ... *p. 91*
revocation ... *p. 74*
seal ... *p. 74*
tender ... *p. 79*
unilateral agreements ... *p. 72*

REVIEW QUESTIONS

1. Explain why an intention to create a legal relationship is an important element of a valid contract.
2. Why is it important that an offer must be communicated before acceptance may take place?
3. How does an advertisement offering a reward for lost goods differ from an advertisement offering goods for sale?
4. Describe the rules for acceptance of an offer and why such rules are necessary.
5. List four instances where an offer might lapse before acceptance.
6. What condition must be met before revocation of an offer is effective?
7. Betacorp holds personal information about its customers. What limitations exist as to how Betacorp may use that information?
8. What is the legal effect of a counter-offer?
9. Why do courts refuse to address the adequacy of consideration?
10. Explain the nature of consideration as it applies to a contract and why its presence is an important requirement for a valid contract.
11. Why is a seal important on certain types of contracts, and how does it relate to consideration?
12. Why, at Common Law, do the courts consider the acceptance on the due date of a lesser sum as payment in full by a creditor a gratuitous promise?
13. Explain promissory estoppel and its uses in a contract setting.
14. Outline the Common Law rules relating to the capacity of minors to contract, and the rationale of the courts in establishing these rules.
15. If a minor is engaged in business, how would the courts deal with contracts entered into by the minor?
16. Explain the difference between minors and drunken persons in terms of their capacity to contract.
17. How is the basis for legality in a contract determined?
18. Describe the three main classes of contract that may be in restraint of trade.
19. Why are the courts reluctant to enforce restrictive covenants in contracts of employment? Under what circumstances would the courts enforce such a restriction?
20. Explain the purpose of a devotion-to-business clause in a contract of employment, and outline the circumstances where the clause would be enforced by the courts.
21. If specialized e-business legislation is silent or absent on a particular point of law, is there a complete void in the law, at least as far as e-business is concerned?
22. At what point is an offer no longer revocable?

DISCUSSION QUESTIONS

1. The Ask a Lawyer scenario raises two contract issues: (1) the testing and purchase of a very complex machine, and (2) the hiring of an employee to operate the machine. The company needs to know if the machine will "work" before buying. What contract issues does this raise, and what can be done to protect the company in the purchase? How might the company protect its trade secrets in the hiring of an employee to operate the machine? What limits does the law impose?

2. Under what circumstances would a restrictive covenant in a contract for the sale of a business be enforceable? Explain why this is the case when contracts in restraint of trade are contrary to public policy.
3. To what extent are parties able to "make their own law" by way of the contents of an enforceable contract? What limitations does the court impose on the rights that the parties can make under a contract?
4. How do you think the rule for acceptance by e-mail will evolve? Will it follow the postal rule, or the receipt rule?
5. Julie is employed as a purchasing clerk by Herbatech, an Ontario firm. She sends an offer by e-mail on behalf of her company to Karim, to purchase equipment. Karim replies by e-mail three days later, accepting the offer, but in the interval Julie left her job at Herbatech. Her e-mail account is closed, and Karim's reply is bounced back as undeliverable. After a cumbersome effort of some days to find out who replaced Julie, Karim is informed that the offer has lapsed as Julie's replacement found an alternate supplier for the equipment. Was there an enforceable contract between Karim and Herbatech?

DISCUSSION CASES

CASE 1

Grand Island Development Corporation owned several cottage lots on Vancouver Island and on September 10 sent a letter to Onshore Construction Company offering to sell the lots for $300,000. Onshore Construction Company sent a reply by return mail on September 13 offering to buy the lots for $250,000.

Grand Island Development Corporation did not respond immediately, but a week later, on September 20, the president of Grand Island Development Corporation met the president of Onshore Construction Company at a charity dinner, at which time the president of Onshore Construction Company indicated that his company was still interested in the purchase of the cottage lots and enquired if Grand Island Development would be willing to reduce the price of the lots. The president of Grand Island Development stated that the $300,000 price was "firm."

On September 23, the Onshore Construction Company sent a letter to Grand Island Development Corporation accepting its offer to sell the cottage lots for $300,000. Due to a delay in the delivery of the mail, the letter was not received at the office of Grand Island Development Corporation until September 28.

In the meantime, when Grand Island Development Corporation had not heard from Onshore Construction Company by September 26, it accepted an offer to purchase the lots from Cottage Contracting Ltd.

Identify the various rights and liabilities that arise from the negotiations.

CASE 2

Base Metal Co. wrote a letter to Steel Manufacturing Co. on May 2 offering to sell it 350 tonnes of rolled steel at $2,200 per tonne. Steel Manufacturing Co. received the letter on May 3. A few weeks later, the president of Steel Manufacturing Co. checked the price of the particular type of steel and discovered that the market price had risen to $2,280 per tonne. On May 22, Steel Manufacturing Co. wrote to Base Metal Co. accepting the offer. Base Metal Co. did not receive Steel Manufacturing Co.'s letter until May 30. Base Metal Co. refused to sell the steel to Steel Manufacturing Co. at $2,200 per tonne but expressed a willingness to sell at the current market price of $2,310 per tonne.

Steel Manufacturing Co. instituted legal proceedings against Base Metal Co. for breach of the contract that it alleged existed between them.

Discuss the rights (if any) and the liabilities (if any) of the parties, and render a decision.

CASE 3

The Silver Mining Company decided to sell of two of its less productive mines, the Blue Lake mine and the Silver Lake mine, and authorized the company president to find a buyer. On June 10, the president wrote a letter to the Amalgam Mining Corporation offering to sell the two properties for $3,000,000.

On June 22, Amalgam Mining Corporation replied by mail to the letter in which it expressed an interest in the purchase of the Blue Lake mine at a price of

$2,000,000, if Silver Mining Company was prepared to sell the properties on an individual basis.

On June 28, the president of Silver Mining Company replied by fax that he would prefer to sell both properties, but if he could not find a buyer for the two parcels within the next few weeks, the company might consider selling the properties on an individual basis.

On July 6, the Amalgam Mining Corporation made an inquiry by fax to determine if Silver Mining Company had decided to sell the properties on an individual basis. The president of Silver Mining Company responded with a fax which stated that it was still looking for a buyer for both properties.

Following this response, Amalgam Mining decided to examine the Silver Lake mine property and sent out its two geologists to do a brief site evaluation. On July 12, they reported back to say that they had examined the mine and, from company core samples, found what might be a potentially economic ore body worth between 10 and 30 million dollars. Amalgam Mining then prepared a letter accepting the offer of Silver Mining Company to sell both properties for $3,000,000. The letter was mailed on July 15.

On July 16, the president of Silver Mining Company found a buyer for the Silver Lake mine at a price of $1,200,000 and signed a sale agreement the same day. He then wrote a letter to Amalgam Mining in which he accepted their offer to buy the Blue Lake mine for $2,000,000. The president of Silver Mining Company received the July 15 letter of Amalgam Mining on July 17.

Discuss the issues raised in this case, and indicate in your answer how the case might be decided if it was brought before the court.

CASE 4

Rafting Company offered white water raft trips involving a relatively short 10-km journey down a swift river. The price of the trip, including overnight hotel stay and meals, was advertised at $300. Hillary and Hal, in response to the advertisement, entered into a verbal agreement with the operator of the tour to join in on the journey, and they agreed to appear at the designated hotel the evening before the date of the excursion.

At the hotel, they met the president of the tour company and paid him the tour price. The next morning, as Hillary and Hal assembled their gear with the nine other passengers, a representative of the company spoke to the participants and instructed each of them to sign a form entitled "Standard Release." The form stated that the operator of the tour was "not responsible for any loss or damage suffered by any passenger for any reason, including any negligence on the part of the company, its employees, or agents." They were reluctant to sign the release, but when they were informed by the tour representative that they would not be allowed on the raft unless they signed it, they did so. When the release was signed, the representative gave each of them a life jacket with a normal adult buoyancy rating. After they donned the life jackets, they were allowed to climb aboard the raft.

During the course of the journey, the raft overturned in very rough water, and Hal and two other persons drowned. An investigation of the accident by provincial authorities indicated that the life jacket Hal had been wearing was not adequate to support the heavy weight of a person his size. The investigation also revealed that due to the swiftness of the river at the place where the accident occurred, a more suitable life jacket would probably not have saved Hal's life.

Hillary survived the accident and brought an action against the tour company under the provincial legislation that permitted her to institute legal proceedings on behalf of her deceased spouse.

Discuss the issues raised in this case, and indicate the arguments that might be raised by each party. Render a decision.

CASE 5

Metro Developments Ltd. owned a parcel of land on which it wished to have a commercial building constructed. An architect was engaged to design the building, and a contractor was contacted to carry out the construction. Contracts were signed with both.

Before the construction was completed, the Municipal Building Department inspected the building and informed the architect that the building violated a municipal by-law and would require certain safety features to be included in the building. Neither the architect nor the contractor were aware of the by-law at the time they entered into their respective agreements with the company.

The safety features required by the by-law could be incorporated in the building at a cost of approximately $15,000, but the contractor refused to do so

unless he was paid for the work as an "extra" to the contract price. Metro Developments Ltd. refused to treat the required changes as an "extra," and it withheld all payment to the contractor on the basis that the construction was illegal. The contractor then instituted legal proceedings against the company.

Explain the nature of the contractor's claim, and explain the defence, if any, that might be raised by Metro Developments Ltd.

Discuss the issue of responsibility in the case. Render a decision.

CASE 6

A medical clinic that had been established for many years advertised in the medical press for an obstetrician. Silvano, a medical specialist, answered the advertisement. Following an interview, Silvano was employed by the clinic and signed an employment contract that contained the following clause:

> Should the employment of the Party of the Second Part by the Parties of the First Part terminate for any reason whatsoever, the Party of the Second Part COVENANTS AND AGREES that she will not carry on the practice of medicine or surgery in any of its branches on her own account, or in association with any other person or persons, or corporation or in the employ of any such person or persons or corporations within the City or within 10 kilometres of the limits thereof for a period of five years.

Silvano worked well with the other doctors at the clinic and developed a good reputation with the patients at the clinic, but after some years, an argument arose between Silvano and one of the founders of the clinic. As a result of the argument, Silvano resigned. She immediately set up practice in the same city in an office building located across the street from the clinic. The clinic continued to operate without the services of Silvano and later brought an action for damages and an injunction against her.

Discuss the factors the courts should consider in deciding this case. Render a decision.

CASE 7

In 1998, Einstein entered the employ of Security Technology Limited as an electrical engineer. He was employed to design electronic testing equipment, which the company manufactured. At the time he was hired, he signed a written contract of indefinite hiring as a salaried employee. The contract contained a clause whereby he agreed not to disclose any confidential company information. The contract also required him to agree not to seek employment with any competitor of the company if he left the employ of Security Technology Limited.

Some years later, Einstein was requested to develop a home security device suitable for sale to home mechanics through a particular hardware store chain under the chain's brand name. He produced a prototype in less than a week and then went to the president's office to discuss the development and production of the equipment.

During the course of the discussion, Einstein and the company president became involved in a heated argument over manufacturing methods. At the end of the meeting, the president suggested that Einstein might begin a search for employment elsewhere, as his job would be terminated in three months' time.

The next morning, Einstein went to the president's office once more, ostensibly to discuss the home security device. Instead, Einstein informed the president as soon as he entered the room that he no longer intended to work for the firm. He complained that the company had never given him more than a two-week vacation in any year and that he often worked as much as 50 hours per week, with no overtime pay for the extra hours worked. In a rage, he smashed the prototype of the device on the president's desk, breaking it into a dozen small pieces. He then left the room.

The following week, Einstein accepted employment with a competitor of Security Technology Limited to do a type of work similar to that which he had done at his old firm. He immediately developed a home security device similar in design to the previous model; then, he suggested to the management of his new employer that they consider the sale of the equipment through the same hardware chain that Security Technology Limited had contemplated for its product. The competitor was successful in obtaining a large order for home security devices from the hardware chain a short time later.

Security Technology Limited presented its new product to the hardware chain a week after the order had been given to the competitor and only then discovered that Einstein had designed the equipment for that firm. The hardware chain had adopted the competitor's product as its own brand and was not interested in purchasing the product of

Security Technology Limited, in view of its apparent similarity in design.

Security Technology Limited had expected a first year's profit of $60,000 on the home security device, if it obtained the contract from the hardware chain.

Discuss the nature of the legal action (if any) that Security Technology Limited might take against Einstein, and indicate the defences (if any) that Einstein might raise if Security Technology Limited should do so.

CASE 8

Tom was tired of running his business and was looking for a buyer so he could retire before the winter. Bill wanted to buy the business, but needed another month to raise the necessary finances. Tom said to Bill, "Look, for $5,000, I'll give you an option to purchase in 30 days, but if you're not ready to buy then for $50,000, I'm going to sell it to Dan." Bill paid Tom the $5,000. Thirty days later, Bill appeared at Tom's door with $45,000. Tom said, "Sorry, I'm going to sell it to Dan. I said the price was $50,000." Bill was confused, and sought legal advice. What advice would the lawyer provide to Bill?

CASE 9

Janine owned a shop selling fine bone china. After a customer dropped an expensive bowl and shattered it, Janine made a new policy by posting a sign reading "Lovely to look at, lovely to hold, if you break it, consider it sold." In time, another customer broke a vase she was examining but refused to pay for it. Discuss the legal position of both Janine and her customer.

CASE 10

Ann's electric clothes dryer was unreliable, and she sought a replacement. She noticed an advertisement in the newspaper for a used dryer, in like-new condition, at a price of $200. She visited the residential address given, and was shown the dryer, sitting against the wall inside a garage. The elderly lady who owned it had died, and her son was selling her possessions. Ann was delighted, paid $200 and took the dryer home. When she tried to install it, she discovered it was designed to run on natural gas rather than electricity, a fact that had not even occurred to her to check. Does a contract exist in this situation?