

# Business Organization

**LAW 122 Fall 2017**

**Professor Daniele Bertolini**

**Class 5 (Chapter 21)**

# How to choose..

Let's focus on these key factors:

## **A. Formation**

(Legally, when does the business org. comes to existence?)

## **B. Liability Regime**

(Who is liable for business' obligations?)

## **C. Financing Method**

(How financial resources are collected to finance the business?)

## **D. Management Risk**

(Legal tools for managing business' risks)

## B. Liability Regime

**As a consequence of the non-separation between business and proprietor (owner):**

1. The proprietor is entitled to all income
2. The proprietor is liable for all obligations
3. The proprietor's personal assets are available for business debts
4. For income tax purposes, the business income (or loss) is included with the personal income or loss of the sole proprietor

# Advantages and Disadvantages

## Advantages

- Simple to start
- Simple to administer

## Disadvantages

- Unlimited personal liability
- Can only raise money by personal borrowing
- As business grows, these problems continue to grow

Conclusion: A Sole Proprietor is best suited for small businesses.

## 2. Partnership

The general partnerships is a form of business organization that comes into existence when:

1. two or more people carry on business together
2. with a view to profit

# A. Formation

- There are no formal requirements for creating a partnership.
- The creation of a partnership is automatic: a partnership comes into existence in law when **two or more people carry on business together with a view to profit**, without the need for any further formality
- Example: You and James agreed that he will buy a lawnmower and you will cut the lawns for interested homeowners and you will split the profit. You created a partnership even if you never made any profit.

## B. Partnership Liability Regime

### 1. No separation between partner and partnership

- A partner cannot be employed by partnership;
- All benefits of partnership accrue directly to partners;
- Each partner is liable for all obligations of the business, (even if the partner did not consent to a particular obligation)

### 2. Partners have unlimited personal liability

- All of a partners' personal assets—not just those committed to the business—are available to satisfy the partnership debt;
- Creditworthy partners make a creditworthy partnership

## Example:

- Eli and Taylor are equal partners in a restaurant business.
- Business's assets are worth only \$100 000.
- The partnerships has asked you to supply \$200,000 worth of restaurant equipment today but wait 90 days for payment.
- You provide the equipment but are not paid on time.
- What can you do?

## Example:

- You could get a judgement against a partnership and seize those assets
- Then seek to recover the remaining money from Taylor and Eli personally.
- You could try to collect \$50 000 from each or \$100 000 from either.

### **Remember: you could seize**

- 1. the business's assets but also**
- 2. the assets held by the partners personally**

# Example

John, Anna, Mark, and Sura established a tree-falling business under the name of HAPPY Enterprises. They enter into a partnership agreement and agree that no expenditure over \$10,000 would be made without unanimous agreement.

Two months ago, without the knowledge of the others, John contracted on behalf of HAPPY to buy a stump-grinder from Wood Suppliers at a cost of \$15,000.

# Example

The stump-grinder has not yet been paid for because, Anna, Mark, and Sura think that HAPPY does not need it, and they did not authorize the purchase.

Wood is threatening legal action against HAPPY to collect what Wood says it is owed.

*Will Wood succeed in collecting the \$15,000 from HAPPY? Explain fully.*

## Case #2: Analysis Issue 1

Ben and Stephanie decided to open a restaurant.

Stephanie contributed a building that she owns, in which the restaurant will operate, that is worth \$300 000 and Ben contributed \$100 000 for renovations.

The parties agreed orally that once the restaurant is open, Stephanie will manage the restaurant on a day-to-day basis, while Ben will keep the books for the business.

They have also agreed that they will share the profits from the business.

The renovations take three months during which both Ben and Stephanie are involved in supervising the work.

The restaurant opens on January 1.

## Case #2: Analysis Issue 2

2) *What relief should Ben seek?*

- *Dissolution*
- *The assets of the partnership are used to pay its debts to persons who are not partners*
- *If any money are left, it would be used to pay debts owed to partners*
- *Then capital contributions owed to partners*
- *Residual capital is distributed to partners in accordance with their entitlement to profits*
- *Assuming the capital is 400; how is it divided between Ben and Stephanie ?*
- *(Hint: Default rule applies? or is there an implicit agreement? Is Ben's \$100,000 considered a loan?)*

## C. Risk management: Sources of Risk

- 1. Each partner is an agent of the partnership** (in the usual course of the business)
- 2. Each partner has unlimited personal liability** (all of his assets are available to satisfy a partnership debt)
- 3. Each partners is personally responsible for both the unauthorized behaviour and the torts of fellow partners** (if committed in the course of the business)

## Limited partnerships (LPs):

**Limited Partner.** At least one partner is limited to that partner's investment in the partnership. LPs must be registered.

• **General Partner.** At least one general partner whose liability is not limited.

• Limited partners have very limited rights to manage the partnership.

# 3) Corporations



A corporation is a **legal person, with a separate legal existence from its directors, shareholders, and officers.**

# Residual Value

Residual Value = value of the corporation after all the debts and other claims have been paid off.

At winding-up, ABC Corp. is worth:	\$100,000
Creditors:	
Smith	(\$10,000)
Jones	<u>(\$10,000)</u>
<b>Residual Value of Corporation</b>	<b><u>\$80,000</u></b>

Therefore, shareholders of ABC Corp. are entitled to \$80,000 upon the winding up of ABC Corp.

# Basic Definitions

- **Shares:** represent a claim on the residual value of the corporation after the claim of all creditors have been paid
- **Shareholders:** residual claimants to the assets of the corporation and elect directors
- **Directors:** responsible for managing or supervising the management of the corporation business and its internal affairs
- **Officers:** appointed by directors and usually exercise substantial management powers delegated by directors

# Liability of Shareholders

## 2. Shareholders have “limited liability”

- no direct liability for obligations of corporation
- can lose investment but no more

## 3. Rare exception: piercing the corporate veil

- serious fraud, wrongdoing, or unfairness
- court willing to impose liability on true culprit
  - court pierces corporate veil
  - court imposes liability on shareholder

## D. Corporate Finance

- **Debt:** loan to corporation.
  - Claim for fixed amount
  - creditor's rights if non-repayment
    - sue for breach of contract or put corporation into bankruptcy
- **Equity:** shareholders' investment
  - claim on corporation's residual value after other claims paid
    - value therefore depends on value of business
    - cannot sue to enforce obligations or put corporation into bankruptcy if not paid

# Types of Shares

- Corporation can have different classes (set in articles)
- **Shares must have three basic rights**
  - vote for the election of directors
  - receive dividends
  - receive property on dissolution after debts paid
- **Common shares** usually have all basic rights
- **Preferred shares** may also exist

# Common v. Preferred Shares



## Common Shares:

- Right to elect directors
- Right to dividends only when declared by the Board of Directors
- Right to residual value, after Preferred Shareholders are repaid.

## Preferred Shares:

- **No right to elect directors**
- Right to receive **fixed dividends at regular intervals**
- Right to be repaid on dissolution **before the balance of the residual value** is distributed to the other shareholders

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# Contracts

LAW 122 FALL 2017

Professor Daniele Bertolini

Class 6 (Chapter 7-8)

# So...what is a CONTRACT?

**A contract is *a legally enforceable agreement* .**



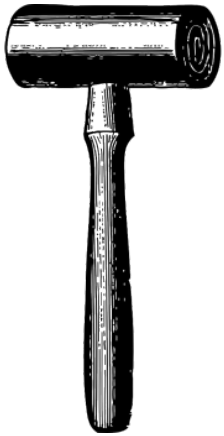
# Contract much?

## Examples

- ✓ Buy a coffee
- ✓ Take the TTC
- ✓ Pay for parking



# Pro Tip: Issue Spotting, 1

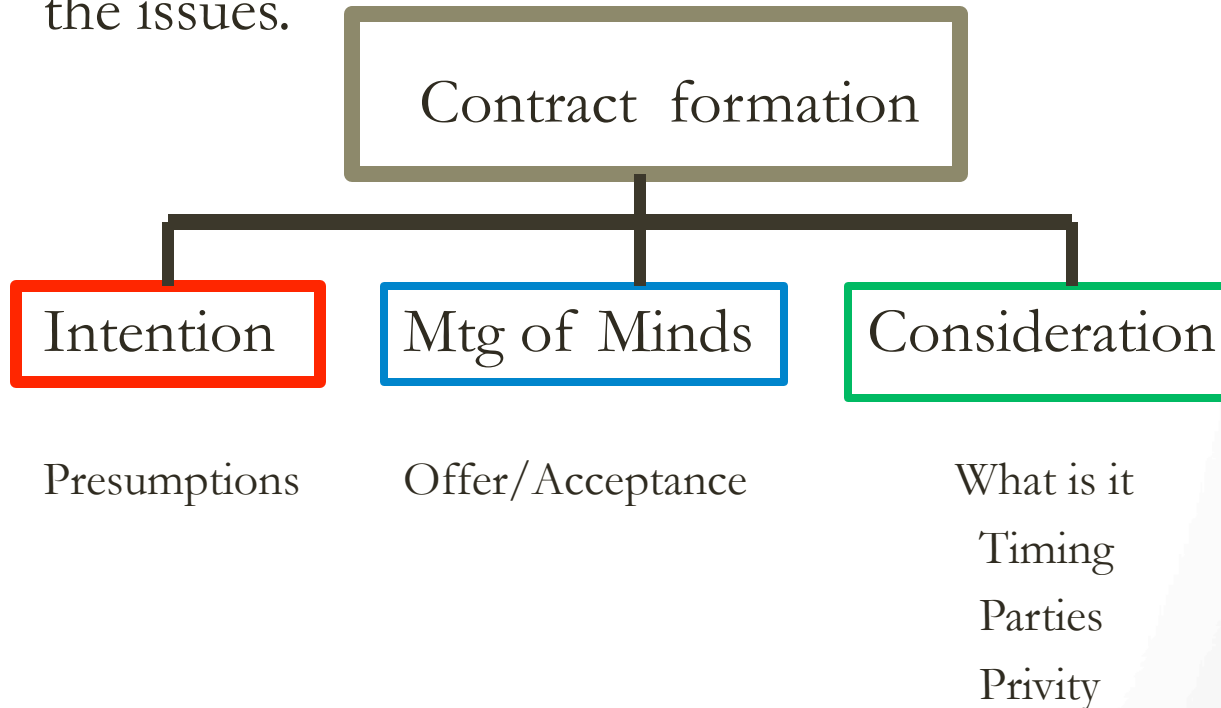
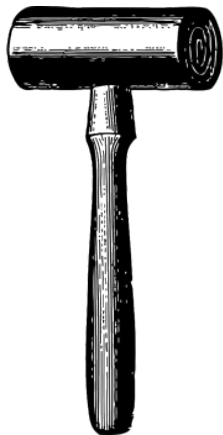


**Q. How can I do issue spotting in contract law?**

- A.** If the parties are fighting about whether or not a contract exists, then the broad issue is contract formation.
- B.** Your typical fact pattern will feature one party saying “we have a contract” and the other saying, “no, we don’t!”
- C. Method:** Are the essential elements present? Is there an offer? Is there an acceptance?

# Pro Tip: Issue Spotting, 2

Once you know that your problem has to do with the essential elements for creating a contract, use a decision tree to help you narrow the issues.



# Does it have to be in writing?

Generally, contract does NOT need to be in writing to be legally enforceable.



# Some terms

**Offeror**: Person who *makes the offer*

- “*Master of the Offer*”

**Offeree**: Person who *receives the offer*

- Exercises the “*power of acceptance*”

# Some Presumptions in Law

## FAMILIES/SOCIAL

- Presume that there is NO intent

## COMMERCIAL

- Presume that there IS intent

Both presumptions are ***rebuttable***.  
(Can be refuted/proved wrong)

# Contract formation

- Once the offeror communicates the offer, a contract comes into existence as soon as reasonable notification of acceptance is given to the offeror.
- Once the contract exists, neither party can change it unilaterally.

## B. Managing Risk: Invitation to Treat

- **Invitation to treat = an indication willingness to receive offers:**
  - person responding to invitation makes an offer
  - person making invitation may then accept the offer
- **Examples:**
  - shelf display;
  - advertisements; catalogues

## Case #3: The Bike, 2

- Suppose you post the following advertisement on Kijiji:  
*“For Sale: one sweet ride. 2013 Specialized Dolce Elite. Excellent condition; well-maintained. \$800.”*
- Now suppose that three people texted you (or phoned or emailed you) at **exactly the same time**. Do you have one contract? Three contracts? How much trouble are you in?

## Case #3: The Bike, 2

- Your Kijiji ad is **an invitation to treat**. And those three messages to you are all offers. **You are the offeree and you have the power of acceptance.**

## C. The Life of an Offer

- Remember: Offer turns into contract by acceptance
- But Offer may be terminated before acceptance

# Five ways an offer ceases to exist

- a) Revocation
  - b) Lapse of time
  - c) Rejection
  - d) Counter offer
  - e) Death or insanity
- In these cases the offer is dead and cannot be accepted or revived.

# Firm offers v. Option

- **Firm offer** = gratuitous promise to not revoke an offer
  - As a general rule, a firm offer is unenforceable
  - Exception: it is enforceable if...
    - Put the promise under seal
- **Options**: a contract in which the offeror receives something of value in return for a binding promise to keep the offer open for a specific period
- **Unlike the firm offer, the option is enforceable**  
(as option is a contract!)

## Case #4: Dickinson v. Dodds (1876) p. 167

- George Dickinson was one of several people interested in buying a piece of land from John Dodds. **On Wednesday**, John wrote to George, offering to sell the property and promising to hold that offer open until Friday morning.
- While George was considering his options **on Thursday**, he learned that John was negotiating with another potential buyer. George immediately tried to find John to accept the offer. Although George failed to locate John that night, he did manage to leave a letter of acceptance with John's mother-in-law. Moreover, he caught up with John the **next morning** and expressed his desire to buy the property.
- By that time, however, George had learned from a third party that the land had already been sold to someone else. George sued John for failing to fulfill his promise to keep the offer open.

## Case #4: Dickinson v. Dodds (1876) p. 167

- The court held that John's promise was unenforceable because it was entirely gratuitous. He had not received anything of value in exchange for his promise to hold his offer open until Friday.

# Forms of acceptance

## 1. Acceptance by promise

- **Bilateral Contract:** Promise exchanged for promise
- both parties have obligations: e.g. “I’ll pay \$7500 and you’ll give me your car”

## 2. Acceptance by performance

- **Unilateral Contract:** An act is exchanged for a promise
- contract exists only when offeree fully performs
- E.g, in response to a reward poster

# Types of Acceptance by Promise

- Acceptance may occur in a number of ways
  - words (written or spoken)
  - conduct may signify acceptance (e.g. handshake)
- Silence
  - Rule: silence alone cannot be acceptance
  - Exception: silence plus prior agreement may be acceptance (e.g. book club)

### 3. Consideration

- A contract involves a **mutual exchange of value**
- Law will **not** enforce gratuitous promises (promises given for free).

# Past Consideration v. Pre-existing Obligation

- **Past Consideration**=Act performed before a contract was proposed
  - It's not a consideration at all!!
- **Pre-existing obligation** = Obligation that existed before the contract but that was not actually performed.

# Past Consideration v. Pre-existing Obligation

## **Three types of pre-existing obligation:**

1. Pre-existing public duty
2. Pre-existing Obligation to a third party
3. Pre-existing obligation to the same party

# Promise to Forgive Existing Debt

## Exceptions:

1. **promise under seal** (= special mark on document)
2. **promise exchanged for new benefit** (e.g. early payment)
3. **statute (incl. Ontario, but not all jurisdictions)**
  - promise enforceable if part payment actually received

# Privity of Contract

- *Privity* is the relationship between contractual parties
  - Parties: people who created contract, provided consideration
- **General rule:** only parties to a contract can sue or be sued under the contract

# Privity of Contract: Strangers

- *Stranger* (or third party): someone **without** privity
  - cannot sue or be sued under contract
  - irrelevant that stranger is beneficiary of contract
    - “I’ll pay \$5 000 to your sister if you give me your car”

# Contractual Terms

LAW 122 Fall 2017

Professor Daniele Bertolini

Class 7 (Chapter 9)

## Pre-contractual statements

1. Assertion of existing fact one party makes with intention of inducing another party to enter into a contract
2. They are not a source of contractual obligations
3. If they prove false, they are an actionable misrepresentation

## Contractual terms

1. Promissory statement: voluntary undertaking to act in a certain way in the future
2. Contractual terms are a source of obligations under the contract
3. If a contractual term is not fulfilled, one of the parties is in breach of contract

## How to distinguish?

The intention of the parties is key to understanding the difference between representation and terms:

1. **Representation:** is made by one party to induce the other to enter into an agreement
2. **Term of the Agreement:** is a statement intended by both parties to form a part of the contract

# Puffs versus Facts

## PUFFS

“This is the most stylish car you will ever drive!”

“This car outranks and outpaces all others in its class!”



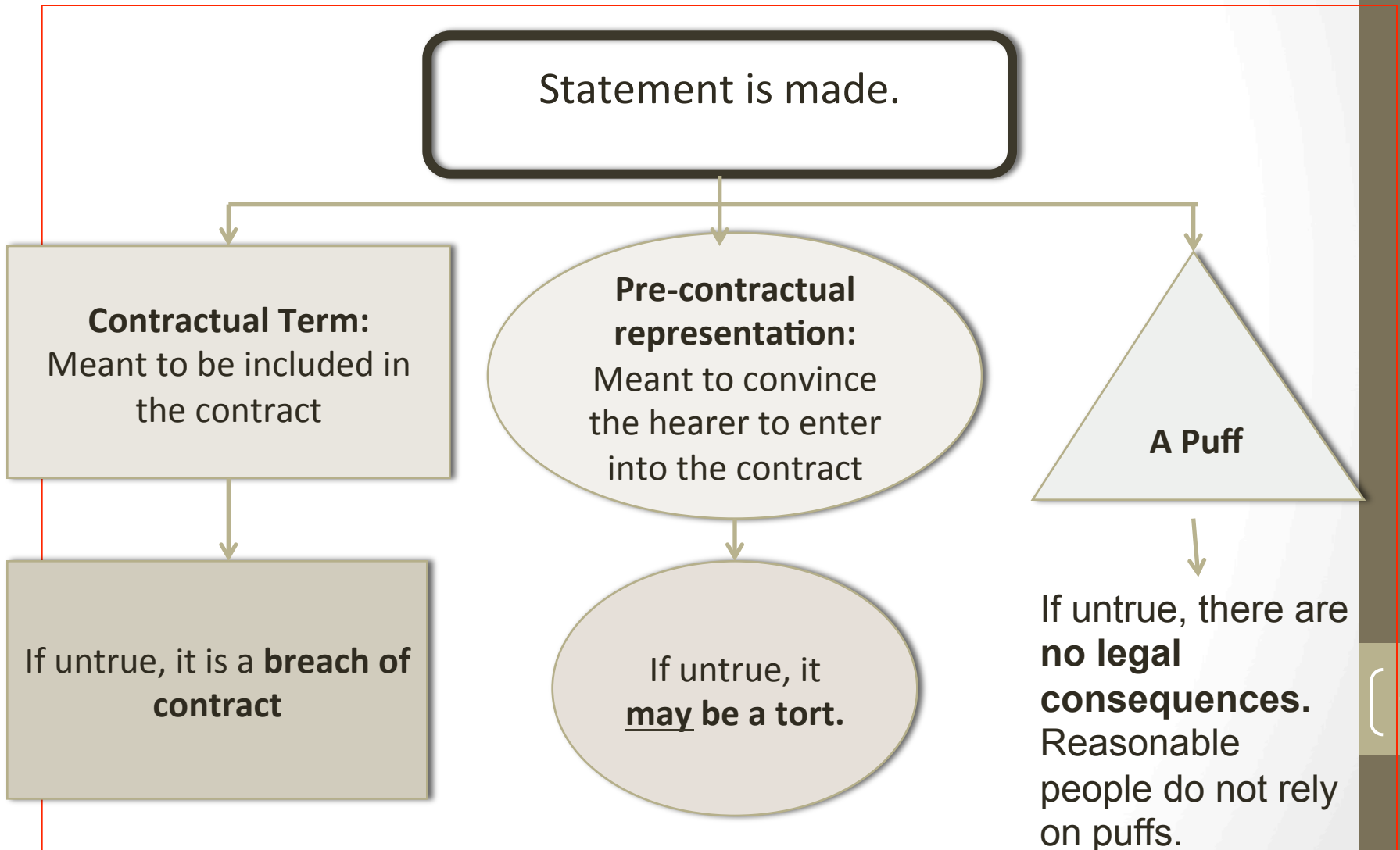
Image courtesy of T. Miedema

## FACTS

“This car has leather interior.”

“This car was voted #1 by Car Dealers Association in 2011.”

# Let's Summarize



# What about non-factual statement?

- People often make non-factual statements during negotiations:
  1. Opinion
  2. Statement Of Future Conduct
  3. Inaccurate Description Of The Law
- **RULE:** In general, non factual statements do not constitute misrepresentation, *unless* they contain an implied statement of fact

# A1. Opinion

RULE: A personal opinion is not usually a misrepresentation, unless it is in party's area of expertise

- EXAMPLE: You say to me: "*I think you will find this model to be very thrifty, indeed*". In fact, you know that this car you own is a notorious gas guzzler.

## Business Decision 9.1

Mrs and Mr Perry decided to construct a building, which they could rent out to stores as part of a shopping complex.

In order to make a proper return on their investment, they determine that their development had to be constructed for less than \$120 000.

The Perrys met with an architect who “guesstimated” that he could design a plan that could be constructed for \$120 000 or less.

The Perrys agreed to have the architect draw up the design plans for a fee of \$ 5000.

## Business Decision 9.1 (Con't)

When the Perry later brought the architect's plans to a contractor, they were told that construction of that building would in fact far exceed their spending limit.

The Perrys now refuse to pay the architect the agreed fee for his plans on the basis of what they claim to be a pre-contractual misrepresentation about the cost to implement his construction plans.

## A2. Statement Of Future Conduct

A statement of future conduct is not statement of fact; it's about a person's future intentions

- **RULE:** Not usually treated as misrepresentation, unless future conduct is described in terms of a present intention [intending v. promising]
- **EXAMPLE:** You say to me: “*I certainly do not intend to sell the neighboring land to Herb’s Sewage Treatment Facility*”. This statement contains an indication of your present state of mind

# Silence as Misrepresentation

However there are at least six occasions when failure to speak will amount to misrepresentation:

1. Silence distorts a previous assertion
2. A Statement is half-truth
3. Duty of Utmost Good faith
4. Special Relationship
5. Statutory Provision Requires Disclosure
6. Facts are Actively Concealed

# Restitution

- Rescission is usually accompanied by an order of “**restitution**”: a giving back and a taking back.
- Unless:
  - Affirmation by misled party
  - Restitution is impossible
  - Third part rights involved

## A. Express Terms

- An express term is a statement made by one of the parties that a reasonable person would believe was intended to create an enforceable obligation
- Even if the **parties** agree on particular terms and write them into a document they may disagree on the interpretation of those words
- **How to interpret express terms?**

## 3) Contractual Terms

**A. EXPRESS TERMS**

**B. IMPLIED TERMS**

**C. STANDARD FORM AGREEMENTS**

# Methods of Interpretation

## 1. **Literal approach**

- words are given their plain and ordinary meaning

## 2. **Contextual approach**

- intentions and surrounding circumstances considered

## 3. **Golden rule**

- words given ordinary meaning unless result is absurdity

## 4. *Contra proferentem*

- ambiguities interpreted against person who wrote the clause

# Implied Terms

**Implied terms** arise by operation of law

1. either through the **common law** (implied by court) or
2. under a **statutory law** (implied by statute)

## C. Standard Form Agreement Terms

**Standard Form Agreement** = Mass-produced documents usually drafted by a party who is in an economic position to offer certain terms on a “take-it-or-leave-it” basis.

**Example: Mortgage.** A bank does not want to negotiate a completely new contract every time it lends money to a customer

# Exclusion Clauses

## Four Requirements for Enforceability

- 1. Term must be clear and unambiguous**
  - ambiguities interpreted against drafter
- 2. Reasonable notice to affected party**
  - heavier onus for unusual or harsh terms
- 3. Assent by affected party**
  - signature is best evidence of acceptance of clause
- 4. Usually not enforced if unconscionable or unfair**

# Boilerplate Clauses

- A Boilerplate clause is a **standard provision** that can be reused in various contractual settings in a virtually unchanged form
- Lawyers rely on boilerplate clauses to satisfy clients who required contracts to be drafted in a hurry at as little expense as possible

# Example: Jurisdiction Clause

*“The courts of [Ontario] will have exclusive jurisdiction to adjudicate any dispute arising under or in connection with this Agreement.”*

*"The parties submit all their disputes arising out of or in connection with this Agreement to the exclusive jurisdiction of the Courts of [the province of Ontario ]".*

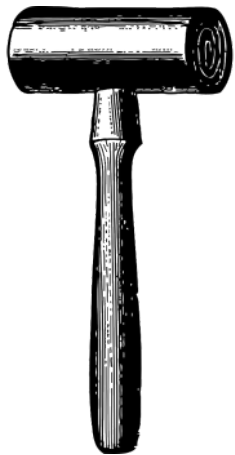
# Contractual Defects

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Class 8 (Chapter 10)

# Pro Tip: Issue Spotting, Part 1



## Q. Contractual defect issues:

- A. Here, the parties are not fighting about whether a contract exists or what it says. **There IS a contract.**
- B. In these problems, one of the parties now wants out of that contract, and is thus looking for a defect so that he or she can avoid the contract.

# Pro Tip: Issue Spotting, Part 2

What are the parties fighting about?

Is there a contract?

What does the contract say?

Can I get out of this contract? How?

Misrep.

Capacity

Unfairness

Illegality

# Chapter 10 Overview

## ➤ **Contractual Defects:**

1. **Misrepresentation (Review)**
2. **Incapacity to Contract**
3. **Unfairness during bargaining**
4. **Illegality**

## 2. Incapacity to Contract

- There can be a problem with **incapacity**
- Capacity: legal power to give consent
- Remedy: Voiding a Contract (i.e., Avoid the legal obligations that the contract would otherwise create)

# Three examples

There are groups with limited power to give consent. Examples:

- a) Minors
- b) Mentally incapacitated people
- c) Intoxicated people

## b) Mental Incapacity

A person may lack capacity because of deficient intellect. Two situations:

1. Court declared person to be lacking in mental capacity: VOID
2. No Court declaration, but person still lacks mental capacity to contract at the time the contract is formed: VOIDABLE

## Be Careful...

### MENTAL INCAPACITY:

contract is voidable only if the other party did/should have recognized the problem

### MINOR:

contract is voidable even if the other party was unaware of the age issue

# Intoxication

- To set aside a contract the intoxicated party must make a prompt election to avoid it once sober

## c) Intoxication

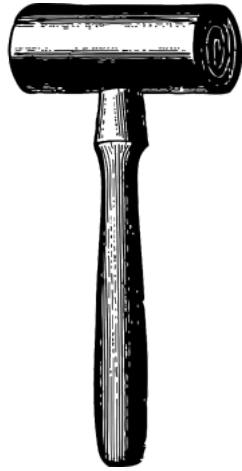
The agreement is voidable if two conditions are met:

1. The person must have been so drunk that they could not appreciate what they were doing
2. The other party must have been alerted to that fact

### 3. Unfairness During Bargaining

- If a disadvantaged party is pressured into an agreement or placed in an unfair position during the bargaining process, the contract may be ineffective
- In particular, the contract may be voidable due to unfairness in the following three cases:
  - A. Duress**
  - B. Undue Influence**
  - C. Unconscionable Transactions**

# Pro Tip: What kind of unfairness?



1. **DURESS:** Problems with the circumstances around the creation of the contract
2. **UNDUE INFLUENCE:** Problems with the relationship between the parties
3. **UNCONSCIONABILITY:** Problems with the way agreement has been formed as well as with content of the agreement itself.

# A. Duress

## **Duress: illegitimate threat of harm**

1. Duress of person:
  - threat of physical violence against a person
2. Duress of goods:
  - threat to detain, damage, or destroy goods
3. Economic duress:
  - A person enter into a contractual arrangement after being threatened with financial harm

# Economic Duress v. Hard Bargaining

1. *Bad faith*: it is one thing for a party to honestly say that it cannot perform without more money; it is another to apply pressure on someone simply because they are vulnerable. The latter constitutes bad faith.
2. Whether or not the victim of the pressure *could reasonably have resisted*. Sometimes, it is reasonable to resist by bringing the matter to court; sometimes the situation requires a much quicker response. Sometimes there is no alternative ways of avoiding coercion.

# Economic Duress v. Hard Bargaining

3. Whether or not the victim started *legal proceedings promptly* after the effects of the pressure passed.
4. Whether the victim *protested* when presented with the pressure. However, a failure to protest is not necessarily fatal if doing so was obviously futile in the circumstances.
5. Whether the victim *succumbed to the pressure without legal advice*; otherwise, agreement to a contractual proposal tends to look more like a sound business decision.

## Practical Tip

In order to avoid repudiation by the weaker party based on duress, where one of the parties to a contract is in much better bargaining position than the other, care must be taken to give the weaker party :

- 1) opportunity to examine a contract carefully, and
- 2) to negotiate the content of the contract

# When Undue Influence Arises

## 1) Fiduciary Relationship

- Undue influence presumed if fiduciary
- Fiduciary party must rebut presumption:
  1. show transaction was fair
  2. show weaker party received independent legal advice (ILA)

## 2) No Fiduciary Relationship

- There is no presumption of undue influence
- Party alleging undue influence must prove it
  - difficult proof if no imbalance in power
- Opposing party can adduce evidence of equality
  - show fairness of transaction
  - show fairness of bargaining process
- Risk management
  - refrain from bullying tactics, recommend ILA

## C. Unconscionable Transaction

➤ A bargain is presumed unconscionable if:

1. contract was improvident, and
2. inequality of bargaining power

# Unconscionable Transaction

## ➤ Presumption rebutted by proof that:

- bargaining process was fair
- other party received independent legal advice

## Insurance Settlement - Case Example— Beach v. Eames (1976)

Mr. Beach had been injured in a car accident. He had not yet spoken to a lawyer nor had he seen his own doctor. He had not yet consulted with his own insurance agent. He had already missed several weeks of work.

He was lying on his sofa, with his legs propped up on pillows when Mr. Pyatt, an insurance adjuster, dropped by unexpectedly. Mr. Pyatt knew that Mr. Beach had limited education and had modest mental abilities. He also knew that Mr. Beach trusted him.

## Beach v. Eames, con't

Pyatt sized up the situation and decide to take advantage of the situation. He offered Beach \$500 to settle all aspects of the claim. Beach agreed, not realizing that his injuries might be much worse than he suspected. Beach signed the agreement.

Later, Beach realized his injuries were very serious and he had made a bad deal. He tried to get out of the contract.

# Legislative Protection

Provincial Legislative/Regulatory protections against unconscionable practices, e.g.:

1. **Disclosure requirements** (how much is this really going to cost, with interest, over time?)
2. **“Cooling off” periods** (new condo units)
3. **Prohibited use of unfair terms**, such as exclusion clauses (wholesale mobile wireless roaming)
4. **Broad discretion** to the court to render harsh or unconscionable agreements ineffective

## 3. Illegality

Contract may be void for illegality by:

### 1. Statute or regulation

- Eg: Rule: Illegal to transact contrary to regulatory statute

### 2. Common Law (contrary to public policy)

- Ex: Rule – Restraint of Trade: An agreement may be ineffective when it unreasonably restricts one party's liberty to carry on a trade, business, or profession in a particular way.

# Discharging a Contract

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Class 9 (Chapter 11)

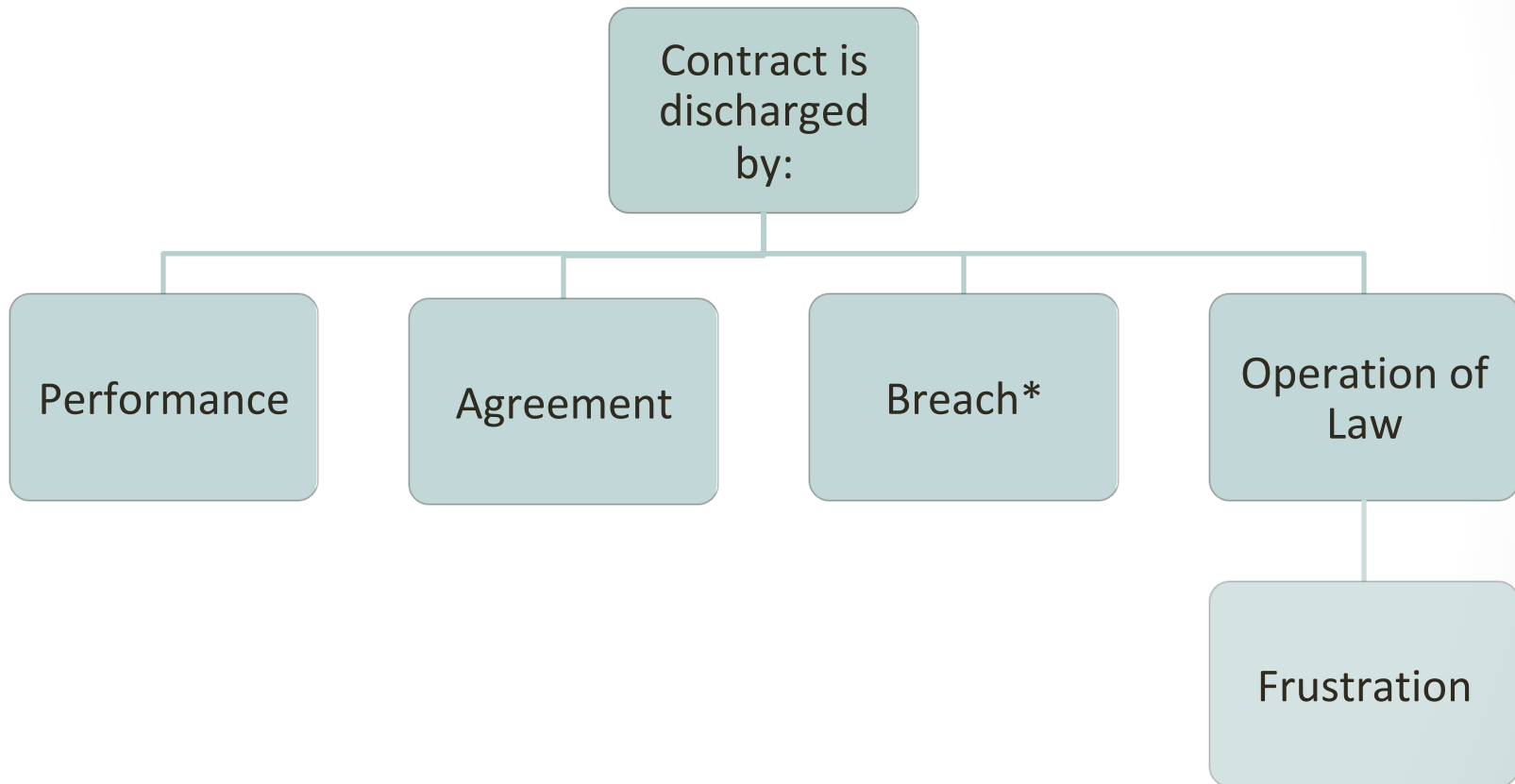
# Voidable or Rescinded Contracts

Some contracts come to an end when they are voided or rescinded

# Discharge

Discharge: a contract is **discharged** when the parties are relieved of the obligation to do anything further under the contract

# Four Ways to Get to Discharge



# 1) Discharge: Issue Spotting



**How can I tell when I am dealing with a discharge of contract situation?**

When the issue is discharge of contract, the parties are not fighting about whether there is a contract (there is) or what is in the contract (i.e., the terms).

Instead, something has happened and now one of the parties wants to know, “*Can I be done with this contract now? Is it discharged?*”

# Pro Tip: Defect versus Discharge

**Q.** Discharge and defect problems sort of sound alike. How can I tell them apart?

**A.** DEFECT problems usually revolve around an issue that affect the formation process of the contract. (E.g., one of the parties was a minor or maybe there was a misrepresentation.)

**B.** But in a DISCHARGE problem, the issue usually comes up during the life of the contract. Maybe someone actually performs or perhaps a party breaches.



# Defect Problem

- The formal requirements for creating a contract are met; the parties are not fighting about the terms, either.
- However, now one party wants out. He or she will try to avoid the contract by pointing to a problem with the wider circumstances when the contract was formed:
  - E.g., misrepresentation; capacity; unfairness during bargaining.

## A. Discharging Contract through Performance

- **Rule:** parties must perform exactly as contract requires
- Any deviation from the terms of the contract is considered a breach, and will entitle the innocent party to a remedy

# EXCEPTIONS: TIME IS OF THE ESSENCE

## ➤ **When time is of essence?**

- *Parties agree*
- *A party insist upon timely performance by giving reasonable notice*
- *Courts*

## ➤ **What are the effects of late performance?**

1. Late performance can be refused, and if that happens,
2. The contract will not be discharged by performance

## II. GENERAL RULE: EXACT PERFORMANCE

### General rule:

- a tender of performance is effective only if the goods or services conform precisely to the terms of the contract
- If the contract is not performed according to its precise terms, then it is not discharged

## Builders & Doorknobs, p. 269

**Facts:** You contract with a builder to build ten houses to full completion. Builder builds the ten houses and completes everything but the doorknobs. **Can the Builder treat the contract as “discharged”? What am I required to do in terms of payment?**

- **Issue?**
- **Law?**
- **Application?**

# Builders & Doorknobs, p. 269

➤ **Issue:** Discharging Contract?

➤ **Rule of Law:**

1. General Rule: A contract can be discharged through the performance of its terms (obligations). Failure to perform means contract is not discharged.
2. But, substantial performance results in discharge of contract.

➤ **Application:** You can not treat the contract as unperformed. The contract is substantially performed, you must pay and then sue for damages for missing doorknobs

# Entire Contracts

- An **entire contracts** says that no part of the price is payable unless all of the work is done.

## Summary: Exceptions to General Rule

- I. Late Performance: time is not of the essence
- II. Substantial Performance: satisfies the contract but is defective in some minor way

# Discharge by Agreement

- If one party has fully performed, a mere agreement to discharge a contract may be unenforceable for lack of consideration.

# Two Possible Solutions

- 1. Find new consideration. “Accord and Satisfaction”**
- 2. Put the promise under Seal. “Release”**

## Two Possible Solutions

- A **release** is an agreement under a seal to discharge a contract; it is an abandonment of a right, which may be given gratuitously (for free) or for inadequate consideration.
- An **accord and satisfaction** is the discharge of a debt or claim by the acceptance of some payment which is agreed to constitute full satisfaction

# Accord and Satisfaction

**Accord and satisfaction** occurs when a party gives up its rights to demand contractual performance in return for some new benefit.

- Accord refers to the parties' new agreement
- Satisfaction refers to the new consideration provided by the party that is relieved of the need to perform the original contract

## Plain Language Example

### Agreement

- Ben agrees to build a water tank for Alex, and Alex agrees to give up his right to Ben's construction of a well.

### Release

- Alex promises to release Ben from the obligation to build the well, and he writes the promise down and writes "SEAL" across the same page.

# Summary: Discharge by Agreement

Parties may agree to discharge contract by either:

## 1) Give fresh consideration (accord & satisfaction)

Arises where **one party has completed** their contractual promise **and agrees to discharge** the second party from further performance **if the second party gives some new consideration.**

Example: Parties agree (accord) that one party will give the other some new consideration (satisfaction) to give up right to performance.

## 2) Make a contract under seal (release)

Arises where **one party has completed** their contractual promise, **and agrees to discharge** the other party from further performance of the contract.

Example: Parties agree (under seal) to 'release' each other from their obligations (without fresh consideration)

## C. Discharge by Breach

When there is a breach of a contractual term (failure to fulfill contractual promise) the innocent party has the option of discharging the contract.

# Defective Performance: Types of Terms

The discharge depends upon the type of term breached:

1. **condition**: substantial term;
2. **warranty**: lesser term; or
3. **intermediate**: hybrid term.

# Warranty versus Condition?

**You ask for:**



**You get:**



# Breach of Condition v. Warranty

## Condition

- Relatively more important term
- Cuts to the heart of the contract
- Innocent party would be substantially deprived of expected benefit of contract due to its breach

## Warranty

- Relatively less important term
- Innocent party would NOT be substantially deprived of expected benefit of contract due to its breach

# Effects: Breach of Condition v. Warranty

## Condition

Innocent party generally has option:

1. affirm contract and claim damages for losses suffered; **or**
2. discharge contract and claim damages

## Warranty

Innocent party has **no** significant option:

1. must affirm contract, no option to discharge agreement, but
2. may claim damages

# Be Careful!

- Can a party bring a contract to an end simply by breaching a condition?
- No: the breach of a condition does not automatically discharge a contract
- **The right of discharge lies with the innocent party!!**

# Four Types of Breach

You can breach in one of four ways:

1. **DEFECTIVE PERFORMANCE (MOST COMMON BREACH)**

- party fails to properly perform contractual obligation
  - buyer usually entitled to reject delivery unless defect truly trivial

2. **DEVIATION:** failure to act precisely or use agreed route

- ship, train or truck departs from the agreed route in a contract for the carriage of goods by land or sea
- carrier in breach may lose benefit of limitation or exclusion clauses in contract

3. **ANTICIPATORY BREACH**

- indication that breach will occur in future
  - innocent party can take action immediately

4. **SELF-INDUCED IMPOSSIBILITY**

- party renders performance impossible
  - contrast: frustration (neither party at fault)

# FRUSTRATION

- The doctrine of frustration applies only if neither party is responsible for the relevant event
- If one party is responsible, then that party bears the loss

# Statutory Rules v. Force Majeure

- Statutory rules (variations between provinces)

Situation	Rule	Remedy
purchaser <u>paid deposit</u> to seller	court's discretion to divide between parties	refund to purchaser or reimburse seller for expenses
purchaser <u>received some benefit</u> from seller	seller can retain money or make fresh claim for expenses	neither claim can exceed value of purchaser's benefit
purchaser <u>neither paid nor received benefit</u>	no claim by seller regardless of expenses	full burden of frustration falls upon seller

# FORCE MAJEURE CLAUSE

- The contract may determine who bears loss through a *force majeure* clause
- A *force majeure* clause aims to protect the parties when part of the contract cannot be performed because of some event that is outside of their control and could not have been prevented through their exercise of due care
- Example at p. 228

# Remedies

LAW122 Professor Daniele Bertolini  
Class 10 (Chapter 12)

# Remedies for Breach of Contract

- 1) Usually, the innocent party enjoys the option to **discharge** the agreement
- 2) Usually—whether or not contract is discharged—the remedy is **damages**
- 3) In some cases, courts grant equitable reliefs—**specific performance** or **injunctions**

# 1. Remedies for Breach of Contract

## General Rule:

Plaintiff is entitled to damages for breach of contract (money), **not** performance as remedy



“Show me the money!”

# Measures of Relief

Type	Description	Example
Expectation	Victim/Plaintiff placed as if contract performed	Give me what I expected to get!
Reliance	Victim/Plaintiff placed as if contract never arose	Give me back what I lost!
Account of Profits	Defendant placed as if breach never occurred	Give me what you never should have received!
Nominal	Symbolize wrongdoing without loss	Give me a small token
Liquidated	Contract sets the quantum of damages	Give me what we agreed I'd get on breach
Punitive	Intended to punish outrageous conduct	Give me enough to hurt you.

# Time of Agreed Performance

The plaintiff does not receive performance, but instead **value** of performance at time of agreed performance (i.e. delivery etc.)

Note: not the time the performance is agreed upon.

# Expectation Damages

- How to Calculate Expectation Damages

**[Expected benefits] – [Expected Costs]**



*The market value  
of what the  
Plaintiff expected  
to get under the contract*



*The remaining  
costs the Plaintiff  
had to pay*

## You be the Judge 12.1.

- Jose agreed to sell a car to Maria for \$5000.
- Maria made a down payment of \$4000
- Jose refused to deliver the vehicle because she discovered that it was really worth \$7500.
- Assuming that Jose has breached the contract, Maria will be entitled to recover expectation damages for \$6500.
- True or False?

## You be the Judge 12.1.

True. Maria must be awarded the difference of \$6500:

\$7500 (value expected under the contract)

—

\$1000 (money still retained and owed to Jose)

## You be the Judge 12.2.

No. Maria will not be entitled to recover any expectation damages.

\$1000 (value expected under the contract)

—

\$1000 (money still retained and owed to Jose)

## You be the Judge 12.2.

- Jose agreed to sell a car to Maria for \$5000.
- Maria made a down payment of \$4000
- Jose refused to deliver the vehicle. He did so despite the fact that the car was really worth only \$ 1000.
- Assuming that Jose has breached the contract.
- Will Maria be entitled to recover any expectation damages?

## You be the Judge 12.2.

- Maria has another option.
- **Which one?**
- She can discharge the contract on the basis of Jose's breach
- Once she has discharged the contract she is entitled to claim either:
  - a) damages for breach of contract (which will be nil), or
  - b) restitution for unjust enrichment

# Unjust Enrichment

1. Enrichment to the defendant
2. Corresponding deprivation to the plaintiff
3. Absence of any juridical reason for the defendant's enrichment

# Issues for Expectation Damages

Complications in calculation of damages:

1. difficulty of calculation
2. alternative performance
3. intangible losses and emotional distress
4. remoteness
5. mitigation of damages

# Causation and Remoteness

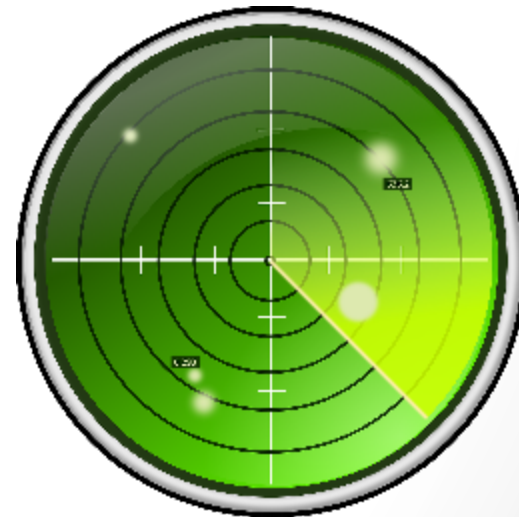
In order to recover losses:

1. loss must in fact be **caused** by breach
2. loss must **not be remote** from breach

# Causation and Remoteness

- Loss is not remote if either:
  - Defendant **actually knew** about the risk of loss, or
  - Defendant **should have known** of risk of loss

Test applied at time contract is created (no hindsight)



## Case 12.4., p 294; Victoria Laundry V. Newman Industries

**Facts:** Contract for boiler delivery by a boiler maker (D) and a laundry owner (P). Defendant broke the contract for failing to deliver the boiler 20 weeks late.

P suffered two types of losses:

- (1) weekly ordinary laundry income \$16
- (2) special government contract \$262 per week

## Case 12.4., p 294; Victoria Laundry V. Newman Industries

**Issue:** Is D liable for both types of expectation losses?

**Legal Test:** Is loss too remote?

**Application:**

Loss for weekly laundry is not too remote—a reasonable person would know that this loss might occur.

Loss for government contract is too remote (so unusual that no reasonable person would know).

# Risk Management

- **From the perspective of the potential victim** of a breach: they should ensure that the defendant is fully aware of the possible consequences of a breach
- **From the perspective of potential defendant**: If they believe that there is a serious risk of substantial liability, they may wish
  1. to demand a higher price,
  2. insist upon the inclusion of a limitation or exclusion clause, or
  3. walk away from the proposed deal

# Mitigation of Damages: Rules

**Rule: Plaintiff has a “duty to mitigate” :**

1. plaintiff encouraged to minimize losses
  - E.g. arrange alternative supply of materials after breach (chip man)
2. plaintiff need merely take reasonable steps
3. plaintiff entitled to recover costs incurred in mitigation

## B. Reliance Damages

- In some situations the victim of a breach of contract is entitled to recover reliance damages
- **Reliance damages** represent the monetary value of the expenses and opportunities that the plaintiff wasted under a contract

# Reliance Damages

The plaintiff is generally entitled to recover either expectation damages or reliance damages, but not both.

## Business Decision 12.2. p. 297

As a music promoter, you hired Ursula to perform a piano concert in exchange for \$5000. Based on your experience in the music business you expected to personally receive a net profit of \$7000 from the concert.

Ursula received full payment when she signed the contract but told you a week later that she was not willing to perform.

You reluctantly cancelled the concert. You are now doubly unhappy. Not only did you pay \$5000 for a piano recital that never occurred, you were also deprived of your expected revenue.

Assume that Ursula has breached the contract, will you claim expectation damages or reliance damages?

## Business Decision 12.2. p. 297

- Expectation Damages: \$12.000
- Reliance Damages: \$ 5.000

## C. Nominal Damages

- Nominal damages
  - symbolize wrongdoing without loss
  - limited to small amount (e.g. \$10)
- Breach of contract is actionable per se
  - wrongful even if plaintiff suffers no loss
- **Risk management**
  - avoid suing for nominal damages. May result in cost award. Judges do not like to waste time on trivial matters

## D. Liquidated Damages

- **Genuine pre-estimate of possible losses in contract**
  - rationale: avoid litigation and provide incentive to perform
- **Effect of liquidated damages**
  - recovery of agreed amount if breach
  - actual size of loss (larger or smaller) irrelevant

## E. Punitive Damages

- Intended to punish and discourage outrageous conduct
- Awarded in addition to compensatory damages
- Defendant must have committed another independently actionable wrong, such as tort.

# Punitive Damages

## General requirements for punitive damages:

1. acting in harsh, vindictive, reprehensible or malicious manner, AND
2. commission of independently actionable wrong
  - E.g. different breach of contract, tort of negligence

# Equitable Relief: 1. Specific Performance

**Awarded only if:**

1. **Damages inadequate**: cannot buy substitute (eg unique land, family heirloom, private shares)
2. **Mutuality**: available to both parties (e.g. cannot be awarded against (or to) infant)
3. No **Judicial supervision**: once-and-for-all order (e.g. grocery store not forced to remain open)
4. **No Personal services**: prohibition on slavery (e.g. actress not required to appear in movie)

# Injunctions v. Specific Performance

## Injunction

- **“Don’t do what you promised not to do!”**
- Larger scope of availability because it poses a smaller restriction on defendant’s freedom
  - “You can do anything other than the prohibited act”

## Specific Performance

- **“Do what you promised to do!”**
- Narrower scope of availability because it poses a larger restriction on the defendant’s freedom
  - “You **MUST** do this required act!”

## Case Brief 12.6: Warner Bros v. Nelson

Bette Davis signed a contract with Warner Bros movie studio. That agreement contained positive and negative undertakings.

Positively, Davis promised to act in the studio's films. Negatively, she promised not to act for anyone else.

By 1937, however, she had enjoyed great success. She therefore decided that her contract with Warner Bros did not pay enough for someone of her stature. She wanted to work elsewhere for more money.

## Case Brief 12.6: Warner Bros v. Nelson

In this case, Courts would not have ordered specific performance of Davis's positive promise to perform in its movies.

However, the studio obtained an injunction with respect to the actress negative promise not to appear in anyone else's movies. The Court held that if Davis wanted to appear on film during the life of her contract with Warner Bros, she had to work for that studio.

The court also held, however, that she was free to earn a living in other ways if she chose.

# Exclusion Clauses

- Contractual term limiting liability (see Chapter 9)
- Exclusion clauses allowed by freedom of contract
- Court nevertheless protects consumer:
  1. clause should be unambiguous, read narrowly against drafter (*contra proferentem* rule)
  2. clause must be reasonably drawn to consumer's attention;
  3. must prove other party agreed to exclusion clause
  4. exclusion clause cannot apply to fundamental breach

# Review: How to solve a legal question?

## 1. Start with the **facts**:

- read carefully and understand the facts as they determine the relevance of any legal points you make later.

## 2. Identify the relevant **legal issues**:

- what are the parties fighting about? What needs to be resolved? e.g. is the contract enforceable? Has A committed a tort against B?
- the order of issues matters, e.g. was there an offer? Was there an acceptance?
- deal with one issue at a time

# How to solve (con't)

## 3. Identify the **rule of law** relevant to the issue:

- is there a legal principle, rule or test relevant? State it in the abstract without referring to the facts yet
- cite supporting authorities

## 4. **Apply** the law to the facts:

- identify the anchor fact = a fact given that links the law to the fact pattern.
- application = law + anchor facts
- drives to your conclusion, which resolves the “issue”

Source: <http://global.oup.com/uk/orc/law/contract/poole/books/001common/guidance/>  
Theresa Miedema's approach to teaching legal reasoning and logic wheel.