

Introduction to Contract Law: Part I

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OVERVIEW

- I. Theory of Contracts
- II. Importance of contracts
- III. Sources of contract law
- IV. Definition of a contract
- V. Elements of a contract

I. Theory of contracts

- **Why are contracts essential to the functioning of the modern societies?**
 - Business transactions and relationships are almost entirely based on contract law
 - Contract law governs the discharge of our legal obligations to each other
- ! Oliver Hart and Bengt Holmström received the Nobel Prize 2016 for their research which sheds light on how contracts help us deal with conflicting interests

CONTRACT THEORY (Hart & Holmström)

- Purpose of contracts
 - Regulate future actions
 - Sharing risk
 - Help us deal with conflicting interests
 - Bring cooperation & trust
- Contract theory's goal
 - Explain why contracts have various forms & designs
 - Help drawing up better contracts

A. Imprecise performance measurement

- **Certainty \neq Incentives** due to:
 - Conflict of interest
 - Measurement inaccuracy
- Performance
 - Link payments to actual outcomes
 - The harder to observe outcomes, less performance based
 - High risk industries: fixed remuneration
- Incentives
 - Sometimes, different interests to be accommodated
 - Multi-tasking confuses tasks and outcomes
 - Team work and risk of free riding

Need to consider balance of fixed and incentive payments

B. Incomplete contracts

- Often difficult to articulate contract terms in advance
 - Need to specify who has the right to decide

Allocating decision rights as alternative to paying for performance

- Eg.
 - Intellectual Property rights
 - Balance between inventor, manufacturer & distributor
 - Shareholding
 - Investors have decision rights if performance sub-par
 - Privatisation
 - Desirability of privatisation depends on the trade-off between cost reduction & quality

II. Importance of contracts

Did you know?

When you:

- signed on to this course
- travelled here on a bus or a train
- bought your morning coffee

→ you entered into various contractual relationships.



- Some more examples of contracts



Employment contracts

- Provision of labour in exchange for payment

Contracts of sale

- Eg: Purchasing air tickets or goods at the supermarket

Contracts for service

- Eg: Staying at a hotel and using its facilities

Contracts of conveyance

- Buying and selling property

- **Examples of Contracts in Aviation**

- Employment contracts
 - eg. Between airline and pilot
- Insurance contracts
- Contracts of carriage (tickets)



III. Sources of contract law

- **2 key sources of contract law:**

1. Common law (or “case law”):

- Law made by judges in the courts



2. Legislation (or “statutory law”):

- Laws made by parliament, passed as “Acts” or “Statutes”

→ Contract law derives from both



IV. Definition of a contract

- A contract is
 - a legally binding agreement
 - between two or more competent persons
 - to do, or not to do, a particular thing
- The agreement is regulated by the law of contract



V. Elements of a contract

- A legally enforceable (common law) contract **must** contain:
 1. offer
 2. acceptance of the offer
 3. consideration
 4. intention to create legal relations
 5. certainty of contractual terms
 6. capacity of the parties to contract
- **All** of these elements are required for a valid and legally enforceable contract

1. Offer

- **What?**
 - An indication of willingness, to do or refrain from doing something, that is capable of being converted into a legally binding contract
- **Parties**
 - Offeror: makes the offer
 - Offeree: receives the offer
- **Requirements**
 - does **not** have to be in writing
 - **must** be promissory in nature:
 - promise to do something or to refrain from doing a certain act
 - **must** be intended to be legally binding
 - **must** be communicated to the offeree
 - **must** be clear and certain in its terms
 - the terms **must** be notified to the offeree (the “ticket cases”)

Offer vs. Invitation to treat

- An invitation to treat
 - = an invitation to enter negotiations (or to make an offer)
- The “acceptance” of an invitation to treat does NOT create an agreement
- There might be only a thin line between an offer and an invitation to treat



- **Examples of invitations to treat:**

- Shop Displays
- Advertisements
- Catalogues
- Sales “blurb”
- Price Lists
- Vending Machines
- Calls for bids at auctions
- Calls for tenders



- **Invitation to treat – Rationale**

- If an advertisement was an offer:
 - The person who placed the advertisement would be required to contract with whoever wanted to purchase the goods at the price stated
- The law recognises that this is not the true commercial intention of the person placing the advertisement
- **! But** some advertisements do amount to offers, capable of acceptance and thus becoming legally binding contracts

Carlill v Carbolic Smoke Ball Co

THE ILLUSTRATED LONDON NEWS

CARBOLIC SMOKE BALL

WILL POSITIVELY CURE

COUGHS	CROUPS	BRONCHITIS	THROAT	INFLUENZA	SORE
IN THE EAR	ASTHMA	LOSS OF VOICE	CHRONIC	SORE THROAT	WINDING
IN THE NOSE	SCURF	HOARSENESS	AND SYMPTOMS	OF ALL	RESPIRATORY


FOR ALL THE ABOVE AFFECTIONS, TAKEN AS DIRECTED, THIS SMOKE BALL WILL BE FOUND TO BE THE BEST.

£100 REWARD

TO BE PAID BY THE
CARBOLIC SMOKE BALL CO.

INFLUENZA,

WHICH IS DEPOSITED




THE CARBOLIC SMOKE BALL,

REGISTERED TRADE MARK.

AS PREPARED BY
DR. WHEEL WRIGHT, M.B.

FOR THE WOMAN'S USE.

LONDON: THE CARBOLIC SMOKE BALL CO., 27, PRINCES ST., HANOVER SQ., LONDON, W.

CARBOLIC SMOKE BALL CO., 27, PRINCES ST., HANOVER SQ., LONDON, W.

CARBOLIC SMOKE BALL CO. 1893

- **How to distinguish offer from invitation to treat?**

- By looking at intention of offeror
- ‘hype’ ‘mere puff’ ≠ intention to bind



- Offer can be made to world at large

- Consideration
- can amount to detriment or effort

➔ The result is a **unilateral contract**:

communication of acceptance of offer is not required

- **Notification of offer's terms: The Ticket Cases**
 - True “agreement” between the parties assumes they are both aware of the offer's terms
 - This rule has been relied on in cases involving the issue and purchase of travel tickets, where the full terms and conditions are provided only **after** payment
 - The leading aviation case: ***MacRobertson Miller Airlines Services*** (1975)

In ***MacRobertson Miller Airlines Services*** (1975):

- Ticket issued after the customer had paid
- Terms & conditions of carriage included sweeping exclusions of liability

Q. Acceptance of airline's offer (and thus binding)?

A. The court: NO acceptance of an offer, as at time of customer's acceptance of the ticket, terms of the offer were not notified

→ The court's 2 alternative views:

- a. The ticket constituted an offer that was open for acceptance by the customer orally or by his later conduct.
- b. The ticket was only a receipt for payment of the fare: agreement concluded only when the customer took his seat on the plane.

E-ticket brings a solution!

→ Pax must accept terms & conditions before submitting payment details

Credit Card Details

Credit Card
 Debit Card

Card Number

Expiration Date /

Security Number

Cardholder's Address Information

Country*
City*
State**
Postal/ZIP Code***

Address*

*Required
**Required for USA and Canada
***Required for UK, USA and Canada

! By clicking the "Continue" button you will be directed to the web page of your card issuer bank for the verification of 3D Secure process. After verification of the bank, you will be re-directed to Turkish Airlines web pages.

- Please note the warnings about card presentation on the next page.
- Refund of payments made via Turkish banks? debit cards may delay due to restrictions in the banking system. For detailed information please call +90 444 0 849 (Turkish Airlines Call Center).
- Please note that Turkish Airlines is based in Turkey and your card issuing bank may charge extra fee for usage of your card in a foreign country even for your online transaction. Please contact your card issuing bank for further details.

I agree to be bound by the rules of [Terms&Conditions](#), [General Conditions of Carriage](#) on THY web site and [fare notes](#) of the ticket reserved, and I confirm the accuracy of the information I entered and that I will be immediately charged for the full amount of the ordered ticket(s) to my card.

Next →

“Terms & Conditions”:

<http://www.turkishairlines.com/en-tr/travel-information/legal-notice/terms-amp-conditions/general-rules>

“General Conditions of Carriage”:

<http://www.turkishairlines.com/en-int/travel-information/legal-notice/general-conditions-of-carriage-passenger-and-baggage/definition>

“fare notes”:

<https://online.turkishairlines.com/internet-booking/goNotes.tk>

Terminating the Offer

- Ways of termination of an offer:
 - (1) Revocation
 - (2) Lapse
 - (3) Rejection By Offeree
 - (4) Implied rejection: counter offer
- Eg: A offers to sell his car to B for \$1000
 - B says to A: "I will give you \$750".
 - B's **counter offer** terminates A's original offer

2. Acceptance

What?

- A final and unqualified assent to all terms of the offer
 - Contract is formed upon acceptance of all offer's terms

• Rules of acceptance:

- Must take place while the offer is still in force
 - Must be on the same terms as the offer
 - Must be unconditional
 - Must be communicated to the offeror
- Some action from offeree required
 - Method of acceptance:
 - If indicated by offeror; must be followed by offeree
 - If not, may be express (by word or in writing) or inferred by offeree's conduct (e.g. using received goods)

Eg: acceptance by simply performing under the terms of the contract

-Offeror: *“I’ll give you €10 if you wash my car”*

-Offeree:



→ Contract!

• Offeror must pay €10

Acceptance must be **communicated** to offeror

Exceptions:

- Implied from past dealings between parties
- Industry custom
- Acceptance indicated by conduct (cf. previous slide)
- Unilateral contracts

Mailbox or Postal rule vs the internet

- Acceptance at time of posting **not** receipt
 - Extended to all situations where non-instantaneous communications are used
- Electronic Transactions legislation:
 - Acceptance at time of receipt of electronic communication
 - Receipt occurs when it enters the addressee's designated information system
 - Otherwise, when it comes to attention of addressee

Acceptance must be final & unqualified

• In case of an offer accepted “*subject to contract*”, 3 legal outcomes possible:

1. There is a contract & one of the terms is that documentation be prepared;
2. There is a contract but nothing can happen until contract prepared; or
3. There is no contract.

Acceptance v Counter Offer

- Counter offer as rejection of offer:
 - Most common law jurisdictions: Counter offer terminates the original offer
 - Because offer is terminated before acceptance, offeree cannot subsequently accept the offer
- Counter offer as acceptance of offer:
 - Some civil law jurisdictions: Courts replace conflicting terms with default terms and find a valid contract
 - Same in some common law jurisdictions (eg: US Uniform Commercial Code)

3. Consideration

- **What is it?**
 - The thing of value that is bargained for
 - “*I will do (or not do) x, if in return you do (or not do) y*”
 - Consideration in this promise goes both ways: It is both x & y
- Consideration “moves from” **promisor** (person making the promise) to **promisee** (receiving benefit of the promise)
- Both parties must receive something of value in return for their mutual promises – ***a quid pro quo***
- Common law will not enforce a gratuitous or bare promise

! **Exceptions:** contracts made as **deeds**

- **Elements of consideration:**
 - a. Bargained for exchange
 - b. Something of value
 - c. Both sides of the agreement
- Something of “value” must be given by promisee in exchange for the promise:
 - can be a *benefit* to the promisor (or a third party) or a *detriment* to the promisee
 - does not have to be adequate (ie: full value) but must be sufficient (ie: have *some* value)
 - not necessarily monetary; needs only to be of value for the person making the exchange
 - one man’s trash can be another’s man treasure!
- Must not be illegal
- Past consideration is not good consideration

- **Consideration may take the form of:**
 - a promise to do something
 - a promise not to do something
 - doing something
 - refraining from doing something
 - a benefit for the promisee
 - a benefit for a third person at the promisee's direction
 - anything of real value to the promisee
 - a detriment to the promisor

! Note

- Contract does NOT need to be mutually beneficial
 - Law allows the Parties to make bad bargains, as long as the parties assent to terms of the contract in full knowledge of those terms
- ‘Peppercorn’ consideration:
 - Symbolic consideration to meet the requirements of law
 - Even value of a symbolic peppercorn (= little) is sufficient
 - Eg: property lease to a friend
- Parties must always engage in good faith and fair dealing during negotiations

- **Examples**

- 1. No valid consideration**

- Airline promises to fly a pax to destination X for free
- No mutual contract unless pax offers some other kind of valuable consideration

- 2. Consideration “moving from” promisee to promisor**

- A agrees to sell a car to B
- B promises to pay \$5,000 to A for the car
- B's consideration = promise to pay \$5,000 to A for the car
- Contract supported by consideration



3. Consideration moving from promisee to third party

- A promises B to pay \$100 to C
 - Consideration moves from A (promisor) to B (promisee), so the contract is supported by consideration
 - BUT only the person receiving the “benefit” can enforce the promise
 - So only B, not C, can enforce A’s promise
- C is not a party to the contract: **“privity of contract”**
 - A person has rights or obligations conferred under a contract only if she is named as a “party” to the contract

Privity of Contract

- Someone who is **not** a party cannot sue or be sued under the contract
- Exceptions: eg. insurance contracts:
 - A family member can benefit from the contract because it would defeat the purpose if the company refused to pay because intended beneficiary was not the contracting party
- English law reformed in 1999 to permit *named* 3rd parties to benefit from contract
- US abandoned privity rules in mid-19th century

Exception to need for Consideration:

•Contracts executed as Deeds

- Must be in writing
- Must be clear on the document's face that it is executed as a "deed"
- Maker of deed must sign, seal and deliver the document
- Must be an independent witness to signing
- Special signature block:

SIGNED, SEALED AND DELIVERED as a deed by)

[name of company and ACN] by its sole director)

and company secretary in the presence of:)

Witness

Signature

Witness Name (print)

4. Intention to create legal relations

- If it can be shown that it was not the intention of the parties to create a legally binding relationship
→ NO contract
- Agreement with family or friends:
 - Presumption that the agreement is not intended to be binding
- Commercial agreements:
 - Presumption that the agreement is intended to be binding

5. Certainty of contractual terms

The agreement must be certain

- General rule: Courts will not enforce vague or incomplete agreements
 - All essential elements of the agreement must be sufficiently clear, especially subject matter and price
- HOWEVER courts will strive to find and uphold a valid contract, having reference to other factors:
 - Trade, customs & usage
 - Previous dealings between the parties

6. Capacity of the Parties to contract

Capable of entering into legal contracts?

- **YES**

- Adults, but not in certain cases (eg: unsound mind)

- **NO**

- Minors, drunkards, persons of unsound mind & bankrupts
- Minors = persons <18 (in most countries)
- Contracts with minors can be
 - valid: legally enforceable
 - voidable: legally enforceable until repudiated by the minor
 - void: having no legal effect

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