TURKISH AVIATION ACADEMY

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AviationAdvocacy

Introduction to Contract Law: Part II

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Agenda

- Part A: The Contents of a Contract
- Part B: When Things Go Wrong: Loss and Liability
- Part C: Terminating the Contract

Part A: The Contents of a Contract

The Elements of a Contract: Recap

- A contract **must** contain the following elements:
- an offer
- an acceptance of the offer
- consideration
- an intention to create legal relations
- certainty of contractual terms
- capacity of the parties to contract

- **All** of these elements are required for a valid and legally enforceable contract

The Contents of a Contract

Question: what is in a contract?

Answer:

- Terms

- *express*
- *implied (“automatic” terms)*

- Conditions

- Warranties

- Exclusion (or “limitation”) clauses

Terms (1)

- The terms of a contract (or the “contractual terms”) are in essence:

- the ***conditions*** or ***duties*** which have to be carried out, and
- the ***arrangements*** which have to be made

by the parties, in order to realize the effect of the contract.

Terms (2)

- Terms have both legal and logistical effect:
- Consider:

  "*you will sell us an aircraft of this type, at this price, and deliver it to us, at this place and at this time.*"

- Some terms are more important than others
- Contract law distinguishes between different types of terms and their legal effect

Terms (3)

- The type and legal effect of terms are important because they govern:

- how important they are to the parties

- how necessary they are to give effect to the contract

- what remedies are fair if the term is broken by a party

Express Terms

- Express terms are terms that the parties have *specifically* and *explicitly* (or "*expressly*") agreed

- Express terms can be in writing or verbal

- Example:

> "*you will sell us an aircraft of this type, at this price, and deliver it to this place at this time*"

Implied Terms (1)

- An implied term is one which is not written in a contract, but is assumed by law (the court) to be included in the contract.

- Example:

  A buys an aircraft from B. A later finds that it will not fly. When he complains, B says that the sale contract did not contain any promise that the aircraft could fly.

The court will deem the contract to include an implied term that the aircraft could fly. **Why**?

Implied Terms (2)

- Implied terms are essential to give effect to commercial agreements in a free-market economy

- A key implied term in a contract of sale is (naturally) that goods are of satisfactory quality and are fit for purpose

Conditions (1)

- A “condition” is a term that goes to the *root* of a contract
- A condition:
- confers or takes away a party’s rights,
- upon the happening (or non-happening) of a specific event
- Example: the aircraft that B sells to A. It is a condition of the sale contract that the aircraft is capable of flying.

Conditions (2)

- Conditions can be express or implied
- *express*: "*the aircraft must be delivered on 1 May 2016*"
- *implied*: "the aircraft will be capable of flying"
- If a party fails to fulfil a condition, the other has the right to claim damages and terminate the contract

Warranties (1)

- A “warranty” is less important than a condition: it does not speak to the the main purpose of the contract

- A warranty is a guarantee or promise which provides a party with an assurance that certain facts or conditions are true or will happen

Warranties (2)

- A warranty can be express or implied
- Implied warranties are often included in contracts by consumer-protection laws
- Example: the aircraft sold by the maker. It is an implied warranty that the aircraft is free of [serious] defects and capable of flying
- A warranty can attach to a product so that a consumer or end-user can take the benefit of it, despite having no direct contractual relationship with the maker

Warranties (3)

- If a party does not fulfil a warranty, the other has the right to claim damages, but does not have the right to terminate the contract

Condition *versus* Warranty

- The sale contract states that the aircraft must be delivered on 1 May. It is delivered one month later, on 1 June.

- If the delivery date is a **condition**, the other party has the right to claim damages for financial loss caused by the late delivery, and to terminate the contract (refuse delivery).

Warranty *versus* Condition

- The sale contract states that the aircraft must be delivered on 1 May. It is delivered one month later, on 1 June.

- If the delivery date is a **warranty**, the other party does not have the right to terminate the contract, only to claim damages for financial loss caused by the late delivery.

Exclusion Clauses (1)

- Exclude all liability for failing to carry out the contract wholly or partly
- Exclusions can be very unfair; so:
- Consumer-protection laws provide strict rules are strict legal rules to prevent the wrongful use of exclusion clauses by businesses

Exclusion Clauses (2)

- Exclusion clauses seek to limit the liability of one party for **financial loss** caused to the other party
- Liability for fraud or wilful misconduct cannot be excluded (common law and civil law differ)
- One party will try to rely on exclusion clauses **when things go wrong**

Part B: When Things Go Wrong: Loss and Liability

Legal Meaning of “Loss” (1)

- What types of “loss” are recoverable as damages from the party in breach?
- In contract law, damages aim to put a party into the position it would have been in had the contract been performed.
- There are rules about what type of loss can be compensated.

Legal Meaning of Loss (2)

- General purpose of damages for breach is to put non-breaching party in the position it would have been in had the contract been properly performed

- The loss is generally some kind of lost gain, whether financial or the benefit of the performance of the obligations/profit and/or anticipated saving. This is "**expectation loss**".

- It is sometimes possible to claim damages to put non-breaching party in position it would have been in had there never been a contract (wasted expenditure, etc). This is "**reliance loss**".

Legal Meaning of Loss (3)

- Generally parties have to elect which of expectation or reliance loss they wish to recover, to avoid double recovery of same loss.

- Reliance loss is generally used where it is difficult to quantify loss on an expectation basis; but it cannot be used to escape a bad bargain.

- Concept of “remoteness”: **Hadley v Baxendale** [1854]). Loss that is too “remote” cannot be claimed by the non-breaching party.

Legal Meaning of Loss (4)

- Remoteness – the two-part rule in ***Hadley v Baxendale***:
  - Part 1: Losses flowing naturally from the breach (i.e. those which would have been **reasonably foreseeable** to the reasonable man at the time of entering into the contract) will not be too remote. In general, a profit is foreseeable; and
  - Part 2: If special circumstances mean that losses beyond those that naturally flowed from the breach are incurred by the party in breach, such losses will only be recoverable if the possibility of their being incurred was in the **reasonable contemplation of both parties**

Legal Meaning of Loss (5)

- Exclusion clauses often seek to exclude liability for (a) direct losses, (b) indirect losses, (c) consequential losses.

- direct losses means losses under Part 1.

- indirect losses means losses under Part 2.

- consequential losses means losses under Part 2.

- Losses falling outside the definition are too remote to be recoverable in damages.

Legal Meaning of Loss (6)

- ***British Sugar*** *case:*

"The Seller will be liable for any loss, damage, cost or expense incurred by the Purchaser arising from the supply by the Seller of any such faulty goods or materials or any goods or materials not being suitable for the purposes for which they are required save that the Seller's liability for consequential loss is limited to the value of the contracts."

Held: only Part 2 losses could be excluded. This meant (in this case) very substantial losses claimable for increased costs of production.

- In order to effectively exclude liability for loss of profits or other direct losses, the clause should make express reference to the exclusion of such.

Quantifying Loss: Damages

- Liquidated Damages or Penalty Clause?
- Liquidated damages: the sum specified in the contract will be payable, even if the loss suffered is greater or smaller. Upside: commercial certainty
- Penalty clause: the loss is recoverable according to ordinary principles.

Other Remedies for Breach

- In addition to damages for loss, there are other remedies:

- *specific performance*: an order to make a party perform his obligations under the contract

- *injunction*: a court order to stop someone breaching a term of the contract

- *suspension* of performance (not valid in common law jurisdictions)

Part C: Terminating the Contract

Terminating the Contract (1)

- A contract can come to an end (“terminate”) in different ways:

- breach
- performance
- express agreement
- doctrine of frustration

Terminating the Contract (2)

- A contract terminates through **breach** when:

- a party has made it clear by words or conduct that he will not or cannot carry out the contract (a “repudiatory” breach); the innocent party may “accept the repudiation”

- a party is guilty of a substantial failure to perform the contract, eg through a breach of a **condition** of the contract

- Where performance of the contract has become impossible as a result of a party’s actions

- Consequences of breach: condition or warranty? Cannot terminate for breach of warranty, only condition.

Terminating the Contract (3)

- A contract terminates through **performance** when:
  - the parties have carried out everything required by the contract, exactly in the way agreed in the contract
  - the parties are then said to have **discharged** their contractual obligations

Terminating the Contract (4)

- A contract terminates by **agreement** when:

- the parties may agree that the contract should end automatically if an agreed event occurs or after an agreed period of time

- This is in effect a waiver or amendment of the contract's original terms

Terminating the Contract (5)

- A contract terminates by the doctrine of **frustration** when:

- some event occurs that is outside the control of the parties

- that event makes it impossible for the contract to be performed

- this is sometimes referred to as "*force majeure*": an event typically considered to be outside the control of the parties, e.g. labour disputes, war, riot, accident, fire, flood, etc. ("Acts of God")

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