

IS4233

LEGAL ASPECTS OF  
INFORMATION  
TECHNOLOGY

**Lecture Week 10: Fundamentals of Contracts**

# Questions Regarding Contracts

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- When is a contract formed?
- If I want to withdraw a contract, when can I do it?
- If a contract is not in written form, does the contract exist?
- What is the breach of contract?
- What can I claim for if my contract has been breached?



# Agenda



- What is a Contract?
- Essential elements of a contract
- Contract vitiating factors
- Discharge of a contract
- Remedies

# Formality Requirement for Contracts

- ❑ Written contracts for some types of contracts such as
  - ▣ Real estate sale/leasing contract
  - ▣ Contracts involve securities (such as stock in a corporation)
  - ▣ Generally, any contracts for the sale of goods with a price over \$500\*
- ❑ Commercial contracts are normally signed in written format
- ❑ But verbal contracts in most cases are valid

A sales contract is an agreement between a buyer and seller covering the sale and delivery of goods, securities, and other personal property. In the United States, domestic sales contracts are governed by the Uniform Commercial Code. International sales contracts fall under the United Nations Convention on Contracts for the International Sale of Goods (CISG), also known as the Vienna Sale Convention.

Under Article 2 of the UCC, a contract for the sale of goods for more than \$500 must be in writing in order to be enforceable (UCC 2-201). The sale of securities is a special case covered in Article 8 (UCC 8-319); to be enforceable a contract for the sale of securities must be in writing regardless of the amount involved. For the sale of other kinds of personal property, a minimum of \$5,000 must be involved before an enforceable contract must be in writing. Otherwise, an oral agreement is enforceable as a binding contract.

# What is a Contract?

- A contract is an agreement between two parties that creates an obligation to perform (or not perform) a particular duty. A legally enforceable contract requires four essential elements:
  1. An Offer (*I'll develop this website for you, if you pay me \$3000*) and An Acceptance (*"I agree, You've got a deal"*);
  2. Consideration (*The value received and given – the money and the website developed*);
  3. Intention to create legal relation; and
  4. Have legal capacity to sign contracts.

# Offer – Definition (1/2)

- a definite promise or proposal made by the offeror to the offeree (not necessarily the performer) with the intention to be bound by such promise or proposal without further negotiation.



# Offer – Definition (2/2)

Offer must be

- Clear -- For terms to be legally valid, a reasonable person must be capable of readily understanding them.
- Definite -- Four primary areas in determining definite terms:
  - the parties;
  - time for performance (term or service schedule); when to finish
  - the price; and
  - the subject matter or scope of service.
- Direct approach to another party to contract

# Invitation to Treat/Offer

more like an advertisement

- An expression of willingness to negotiate
- No intention to be bound as soon as it is accepted by the person to whom the statement is addressed
- The **proposal** before the actual “offer”

e.g. goods catalogue, mail order catalogue, advertisements in newspaper, display of goods in the shelves of a supermarket





# Offer or Invitation to Treat/Offer?

- ❑ Self-service window displaying a good with a price tag
- ❑ Display of a product
- ❑ Price quotation?
  - ▣ Generally not an offer
  - ▣ What if "We quote you \$" and "shall be happy to have an order from you to which we will give prompt attention"?
- ❑ "for sale" sign for a used car?
- ❑ Invitation for tenders (or competitive bids):
  - ▣ A company through an insurance broker invited tenders from insurance companies to cover its employee's medical & life insurance
- ❑ Ads to sell goods by auctions

# Termination of an Offer



- By rejection – a counter-offer is a rejection ; a request for information is not a rejection
- By revocation before the acceptance
- By lapse of reasonable time
- By death of the offeror or of the offeree

After termination, offer is no longer a valid offer and cannot be accepted

# Acceptance - Definition

- Comes into existence after the offeree unconditionally accept the offer
- When 1 party introduces variations/conditions to the terms of the latest proposal, there is no acceptance (i.e. conditional acceptance is not acceptance). Such variations/conditions amount to a counter-proposal/offer. No agreement reached.

e.g. The offeree says, “OK, I accept.”

**Contrast with**

e.g. The offeree says, “I accept subject to conditions....”

e.g. The offeree says, “I accept but.....”

# Acceptance

## **Communication of acceptance**

General rule: Acceptance must be communicated

Exceptions:

1. Offeror waives the necessity to communicate acceptance
2. Certain conditions (like conduct of the offeree) can be deemed to be acceptance
3. Offeror may be prohibited to deny his failure to receive acceptance because of his own conduct (e.g. he did not read the message)
4. Acceptance received by the offeror's agent
5. Postal acceptance rule: acceptance by posting

# Acceptance

- Acceptance must be communicated by the offeree or his authorised agent.

e.g., Paul sent an offer to provide software development service to Company Argent. One of the secretaries in Argent called Paul saying that Company Argent agreed to accept his offer.

**No acceptance. Why?**

- Methods of Acceptance

1. When method is prescribed by the offer, it must be accepted by the prescribed method.
2. When methods are prescribed by the offer, acceptance by any such method.
3. When no method is prescribed by the offer, acceptance by an equally or more efficacious or faster method is OK.

# Acceptance

## Silence is no acceptance

- e.g., An uncle and nephew were negotiating the price of a horse. The uncle wrote offering a certain amount. The nephew did not reply but asked an auctioneer to exempt the horse from an auction. The auctioneer forgot the instruction and the horse was sold to another party. The uncle sued.

*No acceptance-- the nephew had never communicated his intention to accept to his uncle "or done anything to bind himself."*

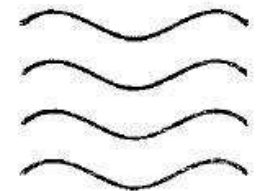
## Contrast:

Paul sent a draft contract to David offering to sell coal. David did not expressly accept the offer but used the coal when they were supplied.

*Implied acceptance.*

# Acceptance – Postal Rule

- If it is reasonable to use post or telegram to send an acceptance, then, acceptance is deemed to be completed when the acceptance, properly stamped and addressed letter of acceptance is posted
- If the post office loses or delays the acceptance letter, there is still a binding contract.
- Contracts concluded by instantaneous means of communication like email, telex, telephone, fax, etc. – acceptance must be received by the offeror



# Consideration

- Something of value in the eyes of the law (need not be of market value) -- Price to be paid for the promise
  - ▣ A promise to do a preexisting duty is lack of consideration
  - ▣ A promise made with respect to events that have already taken place is lack of consideration





# Consideration

- Consideration must be mutual. Both parties must receive something of value.
- May consists of money, goods, promise, or suffering some detriment (e.g. forbearance to sue)
- Consideration must flow from the proposee in respect of any promise.
- Contracts vs. Gifts

considerations in the contracts

# Consideration



- A contract has an option-to-cancel clause – reserving the right to cancel or withdraw at any time? Is there a consideration?

## *Contrast to*

- A contract has an option-to-cancel clause but requires 30 days notice.

# Intention to create legal relation



- Both parties must intend that the agreement is to be bound on them (i.e. they have agreed to bear the duties under the contract).
- Objective test : reasonable man's test
- General assumptions: Commercial agreements have such intention
- “subject to contract” clauses, “honorable pledge clause”, “letter of intent”, etc.— no intention to be bound

# The Capacity of the Parties

- Incapable to contract:
  - ▣ Minors below 18
  - ▣ Mentally disordered, drunk or drugged persons
  
- Companies
  - ▣ Contracts entered into by an officer who has authority to do so binds the company. Authority may be actual, apparent or usual.

# Minors

- Persons under 18 are minors, with limited contractual capacities.
- General rule: contracts signed by minors are not enforceable
- 3 typical exceptions:
  1. Contracts for necessities
  2. Contracts which are beneficial for minors are valid
  3. Some types contracts which are enforceable against a minor unless repudiated by the minor

# Contracts made by mentally handicapped, drunk, drugged



- Mental capacity of understanding the transaction is crucial
- Mentally handicapped have limited contractual capacity
- Contracts signed by Drunk and drugged persons when they are incapable of understanding are invalid

# Expressed and Implied Terms of a Contract

- Expressed terms: Terms that are expressly agreed by the parties orally, in writing or partly orally, partly in writing.
- Implied terms: Terms that work on the presumed intention of the parties to give effect to the business efficacies of the contract.
- Terms can be implied:
  1. By custom and usage of a trade : e.g. a manufacturer will remedy any defects in the garments manufactured, whether they are attributable to supplied materials, etc.
  2. For necessity: sub-contracting does not absolve the supplier from its contractual obligations

# Categories of Contractual Terms

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- Conditions and Warranties
  - ▣ It relates to the remedies available in the event of a breach of contractual terms
  - ▣ Whether a term is a condition or a warranty depends on whether parties intended it to be.
- Conditions
  - ▣ Fundamental term of a contract
  - ▣ E.g., terms about the quality of the purchased goods/service
- Warranties
  - ▣ A term which can be broken without highly important consequences
  - ▣ E.g., client visits the service vendor's site at least once every week

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# What Happens when a Condition is Breached?

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- Remedy of repudiation
  - ▣ The right to treat the contract as at an end; and
  - ▣ The right to sue for damages
  
- For example, Company A runs a computer bureau and carries out ordinary data processing work. Company A orders a new data processing software and specified an exact date of delivery. Company A states in the contract that the software is to be used for an under-negotiation government contract
  
- In this case, if the software developer failed to deliver the software in time, this is breach of condition

# What Happens if a Warranty is Breached?

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- The aggrieved party has right to sue for damages, but
- No right to repudiate contract
  - ▣ The contract is still in force and must be completed by both parties
- In the previous example, if the software developer notified Company A about the late delivery. Company A granted extension of time. If the extension was not put in writing with the new date being firmly stated as a condition, the client must allow a reasonable time for the developer to deliver the software. Company A cannot allow work to drag on for months and then suddenly state that contract will be repudiated if the software is not completed “by the end of this week”.

# Vitiating Factors

- A contract may be tainted by defects that could affect its validity making it void, voidable, illegal or unenforceable. Vitiating factors include:
  - ▣ Mistake
  - ▣ Misrepresentation
  - ▣ Unconscionable contracts
  - ▣ Illegality
  - ▣ Restraint of trade

## Note:

1. Void contract – not a contract and not enforceable
2. Voidable contract – is a valid contract, at least one party is bound by contract (e.g., contracts with minors)

# Mistakes

- Common Mistakes
  - ▣ when an agreement is reached on the basis of a mistaken assumption or belief shared by both parties
- Mutual Mistakes
  - ▣ No meeting of minds – no contract
- Unilateral Mistakes
  - ▣ Mistake by one party while the other party knows the truth.
  - ▣ Mistaken on identity of the parties
  - ▣ Mistaken on terms of the contract

unintentional

# Misrepresentation

- may be intentional
  - Make a false statement of fact to the other party which induces the latter to enter into the contract.
- The contract may be void or may be rescinded (i.e., contract never exist in the first place).
- Misrepresentation can be:
  - ▣ False statement on existing facts;
  - ▣ Makes a positive but incomplete disclosure, the omitted part distorts the truth of the disclosed part; or
  - ▣ Failure to correct an earlier representation
  - ▣ False/failure disclosure of material facts for insurance contracts

# Damages for Misrepresentation

- fraudulent misrepresentation:
  - ▣ Knowingly;
  - ▣ Without belief in its truth; or
  - ▣ Carelessly
- negligent misrepresentation
  - ▣ Common law damages – need to prove ‘special relationship’
  - ▣ Statutory damages – prove that contract entered in reliance on the misrepresentation
- Innocent misrepresentation
  - ▣ No right to ask for damage
  - ▣ But can rescind the contract and then ask for damages in lieu of rescission; or
  - ▣ Get expense compensation
- If misrepresented statement is put into contract terms – breach of contract damage

# Discharge of a contract

- A contract coming to an end by:
  1. Performance/defective performance
  2. Non or defective performance
  3. Agreement in the original contract
- terminate-at-will clause can cancel
- Pre-conditioned events not happen
- Force majeure clause
  - Lawful excuses for breach of a contract
  - Frustration: without the fault of any party of the contract, extraneous change of the environment makes the contract performance impossible

# Remedies for Breach

- Actual breach
  - ▣ Damages (compensation for monetary loss); and
  - ▣ elect to discharge for breach (But no discharge because of breach of warranty or of innominate terms); or
  - ▣ Affirm the contract following an actual breach
- Anticipatory repudiatory breach
  - ▣ Discharge contract immediately without waiting until the time of actual breach, then, sue for damages for non-performance; or
  - ▣ Affirm the contract but no right to sue for damage before actual breach happens
- In some cases, Specific performance
- Duty to mitigate-innocent party must mitigate (minimize) its loss