APSC 450
Professional Engineering Practice

Notes on Contract Law

(September 2019)

DISCLAIMER

These notes are provided strictly for educational purposes and to supplement lectures. They are intended to provide a basic introduction to contract law. As such, they should not be used as a basis for making legal decisions that, in any case, should be made with the assistance of legal professionals.

THE UNIVERSITY OF BRITISH COLUMBIA
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Introduction

When two or more parties enter into an agreement to obtain goods or services, or perhaps to ensure that certain conditions prevail, they enter into a contract, which is a legally enforceable promise or set of promises. Contracts are the primary means of transferring property and services in a market economy. Contract law is unique since it permits the parties to form their own legal relations and to determine what obligations each will accept.

Engineers may be involved in a variety of contracts. One of the more important types of contract is between an engineer and an owner of a project. Engineers are often involved in administering contracts between owners and contractors; contractors and sub-contractors; employment contracts and contracts for supply of goods and services.

The rules of contract law define when a contract arises, how it is interpreted and what legal consequences flow from it. Although it is not necessary that it be in writing, a contract most often takes a tangible paper form. A contract is a legal concept which comes into existence once certain elements are established:

- intention to create legal obligations,
- an agreement resulting from an *offer* (or offers) and *acceptance*,
- *consideration*,
- the legal capacity to contract, and
- legality

The parties to a contract must have the financial ability and competence to enter into a legal relationship. This means that a contract formed by minors, persons of unsound mind, and persons who are incapacitated by drugs or alcohol is unenforceable. Also unenforceable is a contract that requires either party to do anything that is against prevailing law.

Intention to Create Legal Obligations

The law presumes that parties to a contract intend to create a legal relationship. This is a necessary presumption because, without the presumption, it would be difficult to prove that the parties did, in fact, intend to enter a legal relationship; one would have to enquire as to the state of mind of the parties. Given this presumption, in situations of dispute, it is therefore necessary to prove that there was no intention of entering a contract.

Agreements between friends or members of a family are two situations where the courts assume there is no intent to create a legal relationship. Otherwise, for example, forgetting to take out the garbage after agreeing to do so would give a spouse the right to sue for breach of contract. This is unreasonable and could seriously strain the resources of the courts.

Advertisements, the display of goods, or invitations to tender are presumed to be invitations to receive offers rather than legally binding promises. An advertiser is not legally bound by the statements made in an advertisement, although the claims about a product cannot be

misleading. Likewise, the display of goods in a store is only an invitation for a shopper to take the goods and pay for them at a cashier at which point a sales contract is formed. The relationships between statements and intent are summarized in the table below.

Form of statement	Intent
Advertisement, display of goods, or invitation to tender	Invitation to receive offer
Offer	Creation of a legal relationship

In practice, to determine whether the element of intent exists, the courts will try to ascertain whether it can be reasonably inferred from the conduct of the parties that they intended to create legal obligations. The objective test is how a "reasonable bystander" would interpret the conduct of the parties. The mere fact that one party may have reservations about entering into legal relations with the other party may not be enough to render the agreement unenforceable.

A common situation for engineers is where governments or companies request engineering companies to bid on contracts for goods or services. In these situations the party inviting the tenders has an implied contractual obligation to be consistent in their consideration of all bids received. This is illustrated by the case of *MJB Enterprises Ltd. v. Defence Construction (1951) Ltd et al* [1], an appeal resulting from a trial in Alberta. A brief of the case follows:

MJB Enterprises Ltd. v. Defence Construction (1951) Ltd et al (Appellant v. Respondent)

Background and Facts:

- The respondent invited tenders for the construction of a pump house, the installation of a water distribution system and the dismantling of a water tank on the Canadian Forces Base in Suffield, Alberta
- The respondent awarded the contract to the lowest tenderer of the four received despite the fact that the bid did not comply with the tender specifications. The tender documents included a "privilege clause" that stated that the lowest of any tender would not necessarily be accepted.
- The winning bidder was the lowest bidder because it failed to incorporate into its bid how much and what types of fill would be required. The winning bidder submitted a hand-written note that provided final costs of backfill. The other tenderers complained that this note constituted a qualification that invalidated the tender. The respondent nevertheless determined that the note was merely a clarification.
- The appellant, who had submitted the second lowest tender, brought an action to the Alberta Court of Queen's Bench for breach of contract claiming that the winning tender should have been disqualified and that its tender should have been accepted as the lowest valid bid.
- The trial judge found that the note was a qualification but held that, given the presence of the privilege clause, the respondent was under no obligation to award the contract to the appellant as the next lowest bidder.
- The appellant brought the case to the Alberta Court of Appeals who dismissed the appeal.
- The appellant then appealed further to the Supreme Court of Canada.

[1] [1999] 1 S. C. R. 619 (Available at https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/1693/index.do

Issue:
Does the inclusion of a "privilege clause" in the tender documents allow the respondent to disregard the lowest bid in favor of any other tender, including a non-compliant one?

Held:
The Supreme Court reversed the Alberta Court of Appeals' decision. The bid was non–compliant and the privilege clause does not allow the owner to accept a non–compliant bid.

The Agreement

It is important to know when and how a contract is formed. Generally, a contract is formed when one side makes an *offer* and the other side communicates an *acceptance* of that offer. For the sake of clarity, it is best to express the terms of a contract in writing; however an oral agreement can still form a legally binding contract. The following are the characteristics of an offer:

- An offer is a *tentative promise* made by the *offeror*, subject to conditions or involving a request to the other party, the *offeree*.
- An offer must contain sufficiently definite details, such that upon its acceptance the contract is formed.

As discussed above in the section on intent, an offer must be distinguished from an invitation to receive offers or an *invitation to treat*; an invitation to treat merely indicates a willingness to receive offers, whereas upon acceptance of an offer a contract is formed.

A required characteristic of an acceptance is a *positive nature* (i.e., no ifs, ands, buts or maybes). Acceptance can be in words or it can be implied by conduct. An example is when one receives a product ordered via telephone or through the mail. [2] Other requirements of an acceptance are:

- The offeree must agree to the conditions or request made in the offer.
- For acceptance to create a contract, it must be in the same terms as the offer.
- For a valid contract, the acceptance must be communicated to the offeror;[3] once accepted and communicated, a contract is formed and the offer cannot be withdrawn.

The general rule is that an offer is not considered accepted until the offeror receives the acceptance. However, an exception to this rule was made in England in the 1800s for offers and acceptances posted in the mail. This has become known as the *post-box rule*, which may be expressed as:

> An offeror who uses the post office to send an offer is assumed to be willing to have the same means used for acceptance. The offeree completes an acceptance when a properly addressed and stamped letter of acceptance is placed in the mail.

[2] A contract may also be formed by clicking an icon or button on a web site where products are sold.
[3] Acceptance can also be done in silence if that is an agreed method.

From this it follows that the offeror may be bound by a contract without knowing it exists but the offeree would know that it exists. The reason for this is related to an allocation of risk: The offeror took a chance that the post office will deliver the offer on time and therefore should be willing to accept the risk that the letter of acceptance will not necessarily arrive within an anticipated timeframe. However, an offeror could require a specific means of communication in its offer in order to limit this risk of exposure.

An acceptance may be conditional, the conditions being changes to the terms of the offer. This constitutes a *counter-offer*, which is quite common in most business transactions. However, it must be noted that when a counter-offer is made, the earlier offer has been rejected and becomes invalid. The precedent for this was established by a 19th century English case.

> ***Hyde v. Wrench, 1840***[4]
>
> On 6 June 1840 Wrench wrote to Hyde's agent offering to sell the farm for £1000, stating that it was the final offer and that he would not alter from it. Hyde offered £950 in his letter by 8 June, and after examining the offer Wrench refused to accept, and informed Hyde of this on 27 June. On the 29th Hyde agreed to buy the farm for £1000 without any additional agreement from Wrench, and after Wrench refused to sell the farm to him, Hyde sued for breach of contract.

The original offer to sell the farm for £1000 ended when Hyde made a counter-offer to buy the farm for £950. Wrench did not accept the counter-offer and thus there was no contract between the parties.

Instead of counter-offering, Hyde could have simply asked if Wrench was willing to consider a lower price. The original offer to sell would still be in force and Hyde would have been free to accept it within a reasonable period of time.

The relationships between offers and acceptance and the existence of a contract are shown in Figure 1.

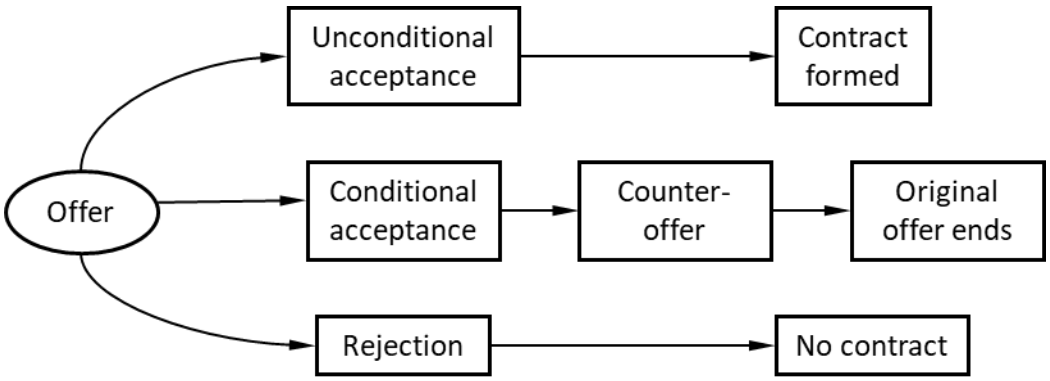

Figure 1 Contract formation: the relationship between offers, acceptance, and rejection.
(after Willes and Willes, 2004:107)

[4] https://en.wikipedia.org/wiki/Hyde_v_Wrench

Unilateral and Bilateral Contracts

Two types of contract may be distinguished. A *unilateral contract* is one in which an offer is accepted by actual performance of an act described in the terms of the offer. This is known as *acceptance by performance*. These agreements do not require communication of acceptance before a contract is formed. An example is the offer of a discounted price upon presentation of a coupon cut from a magazine or newspaper. Another example is the tendering process where, in return for receipt of bid prices from contractors, the offeror promises to consider them. There is some danger with this mode of acceptance since the offeror could withdraw the offer before the offeree completes the work required to accept the offer. However, the courts have held that the offeror is not permitted to withdraw the offer unless that right is reserved in a clear statement. Thus, to avoid unlimited obligations, discount coupons are valid for specific periods and invitations to tender may specify conditions under which the offer may be withdrawn.

A *bilateral contract* occurs when a promise is made by the offeree as a form of acceptance, rather than acceptance by performance. Since the offer is a tentative promise, the contract is, in effect, a promise for a promise. Also each party is both a *promisor* and a *promissee*. Bilateral contracts are very common. In employment contracts the employer promises to pay a salary and the employee promises to work for some future period. The client of an engineer promises to pay in exchange for a promise by an engineer to provide design and supervisory services. Credit sales are yet another example: at the time of formation of the sales contract and for some time afterwards, the goods may not be delivered by the seller nor paid for by the buyer.

Consideration

For a promise to be legally enforceable the recipient of a promise must give something in exchange for that promise. That something is called *consideration*. Consideration may take the form of: (1) another promise, (2) an act, or (3) the payment of money.

Engineers are typically nice people and some have an annoying tendency to provide services to clients, potential clients, friends or friends of friends without fee. Such offers are called *gratuitous promises*. Even though the offer of such services is accepted, there is not adequate consideration (in fact, there is no consideration) and there is therefore no enforceable contract.

Despite the lack of enforceable contract, once an engineer begins to perform a service without consideration, he or she has an ethical and legal duty to carry it out with reasonable care. If damage results from the performance of the service, the engineer may be liable in tort. The duty of care arises for anyone who performs a service without consideration but, in the case of professionals such as engineers, the duty and standard of care are easier to define.

Gratuitous promises can cause trouble even when a contract is in place.

Example

A held an option (a form of contract) to purchase certain mining claims from *B* provided a certain amount of work was done on the claims before an expiry date. However, before the expiry date *A* realized that he would not be able to complete the work. *B* understood this and agreed to allow *A* to proceed with the work. As a result, *A* did not hurry to complete the work before the expiry date, but did complete it soon after. However, *B* then refused to sell the claims saying that the original expiry date applied. *A* brought the case to court. The court did not allow B to revert to the original expiry date.

This is a case of *promissory estoppel* or *equitable estoppel*.[5] *B* made a gratuitous promise to *A* by agreeing to extend the expiry date. However, even though there was no consideration (e.g., a signed document or payment of cash by *A* to *B*) to make the promise enforceable, the legal concept of "equity" requires the promise to be kept. Thus there should be relief for the party that relies on the gratuitous promise, in this case *A*, who acted on *B*'s agreement that *A* could proceed with the work after the expiry date.

Problems Arising from a Contract

Numerous problems may arise to make a contract unenforceable:

Certainty of Terms and Implied Terms

Entering into verbal "handshake" agreements with clients is sometimes an effective way of conducting business quickly; however there are risks associated with conducting business in this manner that must be weighed. Generally speaking, verbal agreements can form legally binding contracts. Verbal agreements, however, are much more susceptible to general misinterpretation, and therefore misunderstandings, than written contracts.[6]

It is prudent practice to set the terms of your understanding down on paper before proceeding with any work so as to minimize the risk of ambiguity and avoid potential problems down the road. If a difficult problem occurs, a disagreement may arise over what the terms of the contract really mean and that is when the "solids" may begin to come into contact with the proverbial wind-generating device. Where the terms of a contract are unclear, it may be held to be unenforceable for lack of certainty, but this is rarely found where the parties themselves treated the contract as binding.

A valid oral agreement, even one accepted by the courts, cannot contradict a term or terms in a written contract. For example, if the terms of a contractual agreement state that changes to an aspect of the work shall be made in writing, but the parties subsequently verbally agree to change terms of their agreement, in the event of a misunderstanding the court may enforce the contract according to what was in the written document.

[5] estopped = prevented

[6] Certain contract types (which fall under the *Statute of Fraud,* found in most Canadian provinces), such as those involving the legal transfer of land, must be in writing.

In addition to terms expressly stated, the court may find terms that are implied in a contract. The court may imply terms where it is satisfied that the parties actually intended the term in question and would have included it, had it been drawn to their attention at the time the contract was made, although this is rare and only happens when necessary. An example of implied terms in a construction contract is "that materials and workmanship shall be of proper standard or quality and the design shall be suitable to the task."

Situations may arise where work proceeds before a contract is formally accepted or before all details of the contract have been agreed upon. In such cases the question may arise whether the formal contract, once formed, applies to the work already performed. Whenever possible, the courts will imply a term of retrospective operation of the contract provisions or will view the final acceptance as applying retrospectively to work done in anticipation of the eventual acceptance.

Agreements to Agree

Some agreements may be found to be unenforceable, as they may constitute agreements to agree. An agreement to agree differs from a binding contract, in that it leaves a central matter to be agreed upon at a later date. However, where the parties indicate a genuine intention to enter into a binding contract and the missing terms are not essential (in essence a promise for a promise), the court may find the contract enforceable.

Misrepresentations

Just as misrepresentations are cause for concern in tort law, they are equally a concern in contract law. Where a representation is false and is relied upon by the other party, the contract may be held to be unenforceable. Misrepresentations may be innocent or fraudulent. Fraudulent misrepresentations occur when the parties know that an element of a contract is false or act recklessly, without concern for its truthfulness. The distinction between fraudulent and innocent misrepresentations is relevant because the legal remedies differ for each.[7]

Termination of Contract

A contract can be terminated in the following ways:

- when all parties have performed all obligations under it;
- at any time by mutual consent of all the parties; and
- where one party to the contract breaches the contract by indicating, either by word or through conduct, that it no longer intends to be bound by the contract. This is a repudiation (or rejection) of the contract. When this occurs, the other party has two options: (1) maintain the contract in force, and sue on it, or alternatively, (2) accept the repudiation as termination of the contract.

[7] We will not delve into these as part of this course; however, those of you with sufficient curiosity can look up some of these differences on the Internet.

Unjust Enrichment

There exists a growing area of law, known as the *law of restitution*, which has its roots in the notions of equity and fairness. The law of restitution provides compensation for situations of unjust enrichment, which occur when one party is enriched at the expense of another without legal justification. For a finding of unjust enrichment, there is a three part test:

> For the principle to succeed, the facts must display (1) an enrichment, (2) a corresponding deprivation, and (3) the absence of any juristic reason, such as contract or disposition of law for the enrichment.

It should be noted that doing something for free may not necessarily lead to an unjust enrichment.

An example of the situation where an unjust enrichment may be found to have arisen is when an engineer performs work for a property owner on the expectation of receiving some benefit, such as future referrals, but such referrals are not forthcoming due to a falling out between the parties. It may be said, that the services provided by the engineer constituted an unjust enrichment to the other party, and compensation may still be possible under the law of restitution. The property owner was enriched, the engineer suffered a corresponding deprivation, and there was no legal reason for the enrichment because there was no contract between the parties. This example illustrates the power of the law of restitution and the possibility of recovery where otherwise not possible under contract or tort law.

When unjust enrichment is found to have occurred, there are two possible remedies: *quantum meruit* or a finding of a *constructive trust*.

Quantum meruit is the amount a person deserves for services rendered. When goods or services are requested, there is an implied promise for payment of what the goods or services are reasonably worth. The court may order the paying of money by the party unjustly enriched to the other, equivalent to the value of services rendered, as valued by the court. The principle of *quantum meruit* also dictates that, absent a loss by the recipient of the work due to work partially performed, the party who either fully or partially performs services for another should get paid for that portion of the work that is satisfactorily completed and at a rate that merits the services rendered.

Example

A asks engineer *B* for technical assistance with an electronic circuit. *B* provides the assistance. Afterwards *A* asks *B* what her fee is and *B* suggests a certain sum. *A* refuses to pay it. In an action for payment for services performed, the court may give judgment in favour of *B* in the amount she requested or for some other amount it finds reasonable.

If instead, *A* had agreed to the figure suggested by *B* but later changed his mind about paying, the court would not concern itself with what it considered reasonable; it would give judgment in favour of *B* for the amount agreed upon.

Alternatively, the court may find that B has constructive trust over the property owned by the unjustly enriched party (A) as a result of the unjust enrichment and, therefore, the true owner of that property is B. Constructive trust remedy is only found where the unjust enrichment was of a nature that it made substantial contributions to the property in question. This might arise in the above example if *B* made substantial contributions to the circuit design – the court may grant her ownership of all or part of the circuit and even related components, and their patents.

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