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Objectives

After completing this chapter, you should be able to:

1. Identify six types of parties that lack capacity or have limited capacity to contract.

2. Distinguish between voidable and enforceable contracts with a minor.

3. Explain what it means for a corporation to act beyond its capacity.

4. Outline the types of contracts that must be evidenced in writing, state the basic writing requirements that must be proved, and summarize the legal effect of non-compliance.

5. Explain how writing requirements protect consumers.

6. Explain the doctrine of frustration and its effect.

7. Determine when a contract is or is not frustrated.

8. Summarize the traditional factors that courts take into account in determining whether an agreement is illegal. Discuss the doctrine of public policy and its effect.

9. Define duress of goods and economic duress.

10. Distinguish between undue influence and unconscionable transactions, and identify when a presumption is created in each case.

Contractual defects are particularly significant because they often provide one of the parties with a defence when the other party commences a lawsuit. In this chapter we survey six different contractual defects and their legal consequences: incapacity, absence of writing, mistake, frustration, illegality, and unfairness during bargaining.

Incapacity to Contract

A person cannot enter into a contract unless they have the legal power to give consent. For example, although a 10-year-old may be able to read, understand, and sign a contractual document, he may not be legally bound by it. The same is true for adults who, for some other reason, lack the ability to consent. To protect specific groups of people, the law has drawn a distinction between those who have the *capacity* to contract and those who do not. **Capacity** is the legal power to give consent. Sometimes the question of capacity depends on a person's ability to understand the nature and consequences of their acts. At other times it does not.

capacity is the legal power to give consent

We will consider six groups of persons who may have no capacity or only limited capacity to create a contract:

minors

mentally disabled persons

intoxicated persons

corporations

associations

Indian bands and Aboriginal persons

public authorities

Personal Incapacity

Minors

The law distinguishes between *minors* and those who have reached *the age of majority*. The **age of majority** is the age at which a person is held fully accountable in law. Those who have not reached the age of majority are **minors**. The law simply says that everyone under the age of majority lacks capacity. In some jurisdictions, including Alberta, Saskatchewan, and Ontario, the age of majority is 18 years. In other provinces, including Newfoundland, New Brunswick, and British Columbia, it is 19 years. Though perhaps overprotective in some instances, the law's approach shields minors from exploitation and the consequences of their own inexperience. It is therefore important for businesses that transact with minors to understand how the law operates.

age of majority is the age at which a person is held fully accountable in law

minors are people who have not reached the age of majority

1. *Age of Majority Act*, R.S.A. 2000, c.A-6, s.3 (Alta); *Age of Majority Act*, RSS 1978, c.A-6, s.2 (Sask); *Age of Majority and Accountability Act*, RSO 1990, c.A.7, s.3 (Ont).

2. *Age of Majority Act*, R.S.N.B. 1973, c.A-4, s.2 (NB); *Age of Majority Act*, R.S.B.C. 1996, c.5, s.1 (BC).

Some contracts are *voidable* at the minor's option. A contract is **voidable** if the minor is entitled to avoid the legal obligations that it created. Note an important legal subtlety here. *Some* contracts with minors are voidable; not *every* contract with a minor is *void* at the outset. If a contract is voidable, the minor may elect to avoid contractual liability. If so, they are relieved of all future liabilities under the contract. However, the minor may also choose to carry out the contract, making the obligations binding.

contract is **voidable** if the minor is entitled to avoid the legal obligations that it created

A minor who wants to avoid contractual liability should do so as soon as possible. Suppose a 15-year-old boy rents stereo equipment for a year. If he elects to avoid the contract after two months, he cannot be sued for the other ten. He can, however, be sued for the rent that accumulated before he avoided the agreement. Furthermore, if there is a substantial delay, a court may say that the boy *affirmed* the contract and therefore lost the right to avoid it. Finally, once a person reaches the age of majority, they must decide, within a reasonable time, whether they want to void a contract that they created as a minor.

The ability to avoid certain contracts does not mean that a minor can take the benefit of a contract and then cancel it with impunity. Minors who elect to avoid contracts must give back any benefits that they received under them.

These rules regarding contracts with minors have been modified by statute in some cases. In British Columbia, for example, the *Infants Act* states that a contract with a minor is unenforceable unless certain prescribed circumstances are met. There are some contracts that minors cannot avoid—contracts for necessary goods and services like food, clothing, education, medical treatment, and legal advice, which are to their benefit. Minors cannot avoid contracts of employment that are to their benefit.

3. RSBC 1996, c.223.

4. This rule aims at ensuring that people are willing to sell such goods and services to minors. Goods that are considered "necessaries" are usually enumerated by statute. See *Sale of Goods Act*, RSPEI 1988, c S-1, s 4 (PEI); RSM 1987, c S10, s 4 (Man).]

Mental Incapacity

Regardless of age, a person may also lack capacity because of a deficient intellect. We need to distinguish two situations. First, if a court has declared a person to lack mental capacity, their contracts are *void* and cannot be enforced at all. Second, even if there is no court declaration, a person may still be considered mentally incompetent. If so, their contracts are *voidable*, just as in the case of a minor. They can avoid the agreement within a reasonable time of becoming competent. There is, however, an important difference between mental incapacity and minority. A minor's contract is voidable even if the other party was unaware of the age issue. In contrast, the contract of a person with a mental incapacity is voidable only if the other party should have recognized the problem.

It is sometimes difficult to tell if a person is incapacitated. A person may obviously lack capacity because of extreme age or because of some kind of impairment in mental function. Often, however, it requires a careful examination of the circumstances, which may be further complicated by the fact that an incapacitated adult may later regain capacity. As a matter of risk management, employees should be trained to identify potential problems.

Intoxication

The rules for drunkenness are similar to those for mental incapacity. An otherwise capable person may enter into a contract while intoxicated. That agreement is voidable if two conditions are met. First, the person must have been so drunk that they could not know or appreciate what they were doing. Second, the other contractual party must have been alerted to that fact. Often, the courts are as much concerned with the possibility of fraud or unfairness as they are with the issue of incapacity. To set aside a contract, the intoxicated party must make a prompt election to avoid it once sober. A failure to do so will be taken as affirmation of the agreement. Case Brief 10.1 illustrates one court decision regarding the effect of intoxication on the ability to contract.

Case Brief 10.1

McLaren v McMillan (1907) 5 WLR 336 (Man KB)

John McLaren had been drinking heavily throughout the day. Shortly after sundown, he was approached by a horse trader named McMillan, who offered him a share in a pony called Silver Coin. After stumbling outside the bar to examine the horse, McLaren expressed satisfaction and signed the relevant documents. When he became sober the next morning, he tried to get out of the deal. Although he vaguely remembered having signed something and also remembered a different transaction that he made with some other cowboy, McLaren tried to withdraw from the bargain with McMillan. McMillan refused.

The court recognized that intoxication could give rise to a contractual defect. However, it held that drunkenness is not a ground for setting the contract aside if it merely "causes excitement" without producing an excessive state of inebriation. Since McLaren's state of intoxication only darkened his ability to reason without actually depriving him of the ability to reason altogether, he was not entitled to avoid the contract.

Business Corporations

Corporations are treated as legal persons. The law distinguishes between *chartered corporations* and *statutory corporations*. In the context of contractual capacity, **chartered corporations** are treated the same as individuals who have reached the age of majority. If a chartered corporation enters into contracts in breach of its charter, its charter may be forfeited, but the contracts made in breach of the corporate charter will still be binding. **Statutory corporations**, on the other hand, have a more limited contractual capacity. Because they are statutory creations, their capacity to contract is limited by the powers given to them through legislation. If a statutory corporation attempts to contract in a manner that exceeds its statutory powers, it acts *ultra vires*, literally "beyond the authority." When a corporation acts *ultra vires,* it lacks the capacity to contract. Those agreements are consequently unenforceable. Generally, the question

is whether the purported transaction is in line with the legal objects and purposes of the corporation. To understand the importance of this, read Business Decision 10.1.

chartered corporations are treated the same as individuals who have reached the age of majority

statutory corporations have limited contractual capacity

5. Corporations and other types of business organizations are considered in detail in Chapters 21 and 22.

Business Decision 10.1

Drafting Articles of Incorporation

Reva is named a director of a statutory corporation. While drafting the constitutional documents of the corporation, she and the other directors enter into a discussion about how best to characterize its objects. According to its current business plan, the corporation will focus exclusively on the business of constructing the exterior of buildings. For this reason, one of the directors, Ling, recommends the following characterization: “To carry on in the business of pouring concrete foundations and erecting building exteriors.” Reva expresses concerns about Ling’s characterization and counters with the suggestion of a much broader description: “To carry on in the business of construction.”

Questions for Discussion

1. Assume that you are also on the board of directors. In what sense is the capacity issue relevant to your decision about whether to adopt the recommendation made by Reva or Ling?

2. What are the advantages and disadvantages of Reva’s broader statement of the objects of the corporation?**Associations**

Capacity issues arise more frequently with another type of business structure—*associations*. **Associations** are usually unincorporated business organizations, including private clubs, charities, and religious societies. Although they share some features with corporations, most associations do not enjoy independent legal existence and are thus incapable of contracting. Therefore, some provinces have legislation that gives contractual capacity to associations involved in such activities as education, religion, and charity. Trade unions may also be given capacity. Those statutes define an association's capacity in much the same way as a statutory corporation's constitution. If an association attempts to contract outside of those limits, it lacks capacity, and its agreement is ineffective.

associations are usually unincorporated business organizations that lack contractual capacity

6. Trade unions are examined in Chapter 27.

Because an association generally lacks capacity, one of its members may enter into a contract for its benefit. Significantly, it is that individual member who becomes liable under the agreement. Unlike corporate officers and directors, individuals cannot escape liability by pleading that they were merely contracting on the association's behalf. On the other side of the bargain, if your business intends to contract with someone who claims to act on behalf of an association, you can manage risk by ensuring that the association has capacity or that the individual personally has the resources to perform the obligations.

Indian Bands and Aboriginal Persons

One kind of unincorporated association that *does* have legal capacity is an *Indian band*. According to the *Indian Act*, an **Indian band** is a body of Aboriginal people whose land and money are held by the Crown. Nevertheless, despite the Crown's role, Indian bands have contractual capacity in much the same way as corporations. They can sue or be sued.

an **Indian band** is a body of Aboriginal people whose land and money are held by the Crown

7. R.S. 1985, c 1-5, s 2 (Can).

8. *Wewayakum Indian Band v Canada and Wawayakai Indian Band* [1992] 42 FTR 40 (FC TD).

The same is not always true, however, of individual Aboriginal persons who qualify as "Indians" under the *Act*. There are some restrictions on their capacity to contract, principally in relation to reserve land. For instance, property on a reserve cannot be used as security for a credit transaction, nor can it be transferred to another member of the band without the Crown's consent. Under section 28 of the *Indian Act*, any deed, lease, contract, instrument, document, or agreement purporting to permit a person other than a member of a band to occupy or use a reserve or to reside or otherwise exercise any rights on a reserve is void, unless approved by the Crown. Other than these special restrictions in the *Indian Act*, Aboriginal persons generally have capacity and are free to contract just like any other person.

9. *Indian Act*, R.S. 1985, c. I-5, s.24.

Public Authorities

Many contracts are created on a daily basis by public authorities at the federal, provincial, and municipal levels. Generally speaking, a public authority acting on behalf of a governmental body has the capacity to contract, independent of any specific statutory authority to do so. The only limit on a particular official's capacity to contract is the division of powers section of the *Constitution Act 1867*—in order to have capacity, the action must be consistent with that division of powers.

10. PW Hogg *Liability of the Crown* 2d ed (1989) at 161–62.

Concept Summary 10.1

Managing Risk in Association with Incapacity

Train employees to identify potential capacity problems in the contracts that your business enters into.

Be aware of the rules governing contracts with minors, particularly if your business is likely to enter into contracts with minors.

In potential cases of contracts involving minors, mental incapacity, or intoxication, take steps that will help to show that the other party has affirmed the contract. For example, you might attempt to have the other party commence performance of their obligations under the contract or pay them money under the contract. If they begin performance or accept the payment, then these may be taken as signs of affirmation of the contract. These steps should be taken at a time when you know they are no longer a minor, mentally incapacitated or intoxicated.

Be aware of whether your company may contract with statutory corporations, associations, Indian bands, individual First Nations' people and public authorities, and act accordingly.

Where you are not certain about the other party's capacity, you might consider requiring a written representation from the other party in the contract which states that they have the capacity to enter and fulfill the contract. If it later turns out that they did not have capacity, then you may have an action against them in tort for misrepresentation.

Absence of Writing

For most contracts, there are no formal requirements. However, certain types of contracts must be *evidenced* in writing. That requirement first arose as a result of an old

piece of English legislation—the *Statute of Frauds*. More recently, consumer protection legislation has required certain types of contracts to be made in writing. Both are discussed below.

11. *Statute of Frauds* 1677 (29 Cha 2) c3.

Statute of Frauds

The *Statute of Frauds* required some contracts to be evidenced in writing as a way of reducing the risk of perjury, or lying in legal proceedings. The requirement was intended to discourage people from falsely claiming the existence of oral contracts. That rationale is less persuasive today. Electronic and paper documents can now be produced, altered, and reproduced with a few clicks of a mouse. For that reason and others, many jurisdictions have amended their legislation. And some jurisdictions, like British Columbia and Manitoba, have repealed the Statute altogether. As electronic commerce continues to expand, it can be assumed that the issue will be examined even more broadly.

12. Law reform has been recommended in other provinces, including Ontario and Newfoundland. See Ontario Law Reform Commission *Report on the Amendment of the Law of Contract* (1987) c 5; M Bridge "The *Statute of Frauds* and the Sale of Land Contracts." (1986) 64 *Can Bar Rev* 58.

Despite such law reform, risk management still requires understanding the *Statute of Frauds*, even for businesses in British Columbia and Manitoba. After all, a company in Kamloops or Brandon may enter into a contract with a party in another jurisdiction where the Statute is still in force. We will therefore discuss the types of contracts that must be evidenced in writing, the basic writing requirements that must be proved, and the legal effect of non-compliance.

Types of Contracts That Must Be Evidenced in Writing

Only certain types of contracts fall under the *Statute of Frauds*. In Chapter 13, we will examine the circumstances in which an agreement for the *sale of goods* must be evidenced in writing. For now, we can look at three other types of contracts: guarantees, contracts for the sale of an interest in land, and contracts not to be performed within a year.

13. Most provincial statutes require writing in other circumstances, including (i) ratifications of contracts made by minors upon reaching age of majority, (ii) promises by executors or administrators to be personally liable for the debts of a testator or intestate, (iii) contracts made upon consideration of marriage, (iv) assignment of express trusts, (v) creation of trusts of land, and (vi) leases or agreements to lease land for a term exceeding three years.

Guarantees The Statute applies to *guarantees*. A **guarantee** is a contractual promise by a third party, called a *guarantor*, to satisfy a debtor's obligation if that debtor fails to do so. For example, you may apply for overdraft protection that allows you to withdraw more than your bank account actually contains, which is, in effect, a bank loan. The bank may refuse that arrangement unless you find a third party (such as your parent or your spouse) to guarantee repayment.

a **guarantee** is a contractual promise by a third party, called a *guarantor*, to satisfy a debtor's obligation if that debtor fails to do so

14. Guarantees are examined in Chapter 23.

The guarantor gives a *conditional* promise, and is required to discharge the debt only if you fail to do so. A guarantee can be distinguished from an *indemnity*. An **indemnity** is an *unconditional* promise to assume another's debt completely. To continue with our example, if your spouse promises to indemnify the bank for your overdraft, the bank is entitled to collect payment from your spouse as soon as the overdraft amount becomes due, even if the bank has not bothered to ask you for payment first. An indemnity is therefore not a promise to answer for another's debt. It is a promise to assume another's debt altogether.

an **indemnity** is an unconditional promise to assume another's debt completely

In many provinces, the *Statute of Frauds* applies to contracts of guarantee but not to contracts of indemnity. Consequently, the bank will not be able to demand payment from the guarantor unless that agreement was evidenced in writing. However, a bank may be able to enforce an indemnity even if the agreement was entirely oral. In British Columbia, the judicial distinction between guarantee and indemnity has been abolished.

Contracts for the Sale of an Interest in Land Contracts for the sale of an interest in land are unenforceable unless they are evidenced in writing. It is sometimes difficult to distinguish contracts that concern an interest in land from those that do not. Consider the example in You Be the Judge 10.1.

15. The sale of interests in land is discussed in Chapter 16.

You Be the Judge 10.1

Van Berkel v De Foort [1933] 1 WWR 125 (Man CA)

Van Berkel entered into an oral agreement that permitted De Foort to cut and remove a crop of wild hay from his land in exchange for a promise to pay $500 upon removal of the crop. De Foort had intended to use the hay to feed his dairy cattle. In the early part of the autumn that year, De Foort decided to give up the dairy business altogether. No longer having any need for wild hay, De Foort simply left the crop on the land to spoil. Van Berkel sued for breach of contract. De Foort attempted to escape liability by pleading the *Statute of Frauds*. He claimed that the contract concerned the sale of an interest in land and was therefore unenforceable since it was not evidenced in writing.

Questions for Discussion

1. Do you think that the contract entered into by Van Berkel and De Foort was a contract for the sale of an interest in land?

2. Should De Foort be able to walk away from his contractual obligations simply on the basis of this formal defect?

Other cases are more clear-cut. For example, a contract to repair a building need not be evidenced in writing, nor must an agreement for room and board. On the other hand, a long-term lease of land clearly must be evidenced in writing.

Contracts Not to Be Performed Within a Year Contracts that are not to be performed within a year of their creation are unenforceable unless they are evidenced in writing. This extends the writing requirement to all sorts of agreements of indefinite duration regardless of their subject matter. Because the Statute applies so broadly, it can catch parties by surprise. Contrary to their expectations, they may not have an enforceable agreement. The courts therefore tend to interpret this part of the Statute quite narrowly. For instance, they usually say that a contract is not caught if it could *possibly* be performed within one year. And sometimes they go to great lengths to enforce oral agreements, notwithstanding the existence of the Statute.

Writing Requirements

If a contract falls within the Statute, the court must decide if the writing requirement was satisfied.

Form and Content of the Note or Memorandum

Either the contract must be in writing or there must be a note or memorandum that provides evidence of it. The document does not have to take any particular form, but has to (i) provide evidence of the essential elements of the contract (such as the parties' names, the subject matter of the agreement, and the price), and (ii) be signed by the party against whom the agreement is being enforced. The courts are often lenient. For instance, they sometimes allow the signature requirement to be satisfied by a name on letterhead or an invoice. Furthermore, they are sometimes satisfied by the combined effect of several documents, even if they do not expressly refer to each other.

16. *Harvie v Gibbons* (1980) 109 DLR (3d) 559 (Alta CA).

Effect of Non-Compliance The *Statute of Frauds* renders some contracts *unenforceable* unless they are sufficiently evidenced in writing. Such contracts therefore cannot support an action for breach of contract where the defendant pleads the *Statute of Frauds* as a defence. If one party does not perform, the other cannot demand a remedy. This does not mean that their agreement is entirely irrelevant. Their contract is not void; it is merely unenforceable. It can therefore be used to pass property and may provide a defence. The difference is somewhat obscure but can be demonstrated through examples. Suppose that someone pays you $5000 as a down payment under an oral contract for the sale of land. A down payment acts as part of the purchase price, but it also provides an incentive to perform. If the payor does not go through with the deal, the payee can keep the money. Now suppose that the other party refuses to complete the transaction. Although your contract is unenforceable, it still provides a valid explanation as to why you do not have to repay the $5000. To use another example, if a party provides goods under an oral contract and the other party accepts the goods, and the contract is found unenforceable under the *Statute of Frauds*, then the doctrine of *quantum meruit* may require the party who accepted the goods to pay for the benefit it received.

Consumer Protection and Writing Requirements

Some consumer protection laws require certain types of agreements to be made in writing in order to protect consumers' interests. By requiring agreements to be in writing, and in some cases, that a copy of the agreement be provided to the consumer, these laws can help prevent exploitation of consumers and prevent disputes about the terms of the contract. Reducing disputes about the terms of an agreement is good for consumers, who are often the weaker party to the contract and who do not have the resources to fight disputes, but it is also good for business.

Under Ontario's *Consumer Protection Act 2002*, for example, all personal development services contracts must be made in writing in cases where the consumer's payment in advance is required under the contract. Personal development services contracts are

service contracts in the areas of health, fitness, diet, modelling, talent, martial arts, sports, and dance. If such contracts are not made in writing, then the business is not permitted to require or advance payment from the consumer. Ontario's consumer protection law also requires businesses to deliver a written copy of an Internet contract in cases where the consumer is required to pay more than a prescribed amount under the contract in advance.

17. *Consumer Protection Act, 2002*, S.O. 2002, c. 30, Sch. A, s.30 (Ont.).

Concept Summary 10.2

Managing Risk in Association with Writing Requirements

Ensure that guarantees, contracts for the sale of an interest in land and contracts not to be performed within a year are always made in writing.

To meet the writing requirement, you should, as a minimum, (i) provide evidence of the essential elements of the contract (such as the parties' names, the subject matter of the agreement, and the price), and (ii) ensure that the party against whom the agreement is being enforced has signed the written document.

To avoid the uncertainty and debate that oral agreements can create, all contracts should be written whenever possible.

Businesses should ensure that they understand the requirements that may exist under provincial consumer protection laws to put certain agreements in writing and to provide consumers with a copy.

Mistake

We have examined incapacity and the absence of writing. A third kind of contractual defect arises from *mistakes*.

General Principles

Contracts are based on agreements. As discussed in Chapter 7, contracts require a meeting of the minds, or *consensus ad item*, which is a shared mutual agreement to enter into an enforceable transaction on a particular basis. However, anyone involved in business knows that people sometimes are mistaken about their agreements.

Some mistakes occur when an error affects the basic process of contract formation. When that happens, the mistake may negate the existence of an agreement between the parties. And without an agreement, there cannot be a contract.

Other mistakes make it impossible for the object of the contract to be achieved. Here, the mistake does not affect the process of contract formation but rather pertains to the very existence of the contract's subject matter. In that case, the contract may be defective.

Mistakes Preventing the Creation of Contracts

Two types of mistakes prevent the creation of a contract: mistaken identity and mistake as to subject matter.

Mistaken Identity Many business relationships are based on trust and reliability. People are more willing to invest in institutions that are known to be reliable. Financial institutions are more willing to lend money or give credit to people who have a history of paying their debts. Therefore, a mistake about corporate or personal identity may become a contractual issue. The situation is even more difficult if a con artist obtains goods under a contract and then resells them to a third party. The person who was

duped under the first transaction may try to recover the goods from the third party on the basis of the mistake.

Sometimes that approach succeeds; sometimes it does not. The courts are required to weigh the interests of the seller against those of the innocent purchaser. Mistaken identity will therefore not render a contract defective unless (i) the mistake was known to the other contractual party, and (ii) the mistake was *material*. A **material mistake** is one that matters to the mistaken party in an important way.

a **material mistake** is one that matters to the mistaken party in an important way

It is difficult to always be clear about the difference between mistakes and a lack of *consensus ad item*. The difficulty in this distinction is revealed in Business Law in Action 10.1 below.

Business Decision 10.1

Shogun Finance v. Hudson [2003] UKHL 62

A fraudster approached Shogun Finance to finance the purchase of a valuable vehicle. The fraudster claimed that his name was Mr Patel. He presented false identification which confirmed this identity. In fact, Mr Patel was a real individual with a good credit rating. Shogun performed a credit check against ‘Mr Patel’ and found that he had good credit. On this basis, Shogun financed the fraudster’s purchase of the vehicle thinking that he was Mr Patel. The fraudster then sold the vehicle to an innocent purchaser, Mr Hudson. When the fraudster didn’t make his payments to Shogun, Shogun sought to repossess the vehicle.

By a 3 to 2 majority, the House of Lords held that no contract had been created between Shogun and the fraudster because no agreement was reached between them—there was no meeting of the minds. The majority held that the fraudster did not intend to contract with the finance company and that the fraudster’s identity was fundamental to the transaction for the purpose of checking credit. Therefore, the court

remarked that there was either no meeting of the minds, and therefore no contract formed, or there was a contract formed between the real Mr Patel and Shogun. In neither case was a contract formed between the fraudster and Shogun. With no contract formed, the fraudster had no title to the vehicle and could not pass title to Mr Hudson, meaning that the vehicle in fact belonged to Shogun. If the contract between Shogun and the fraudster had been upheld, then Mr Hudson would have been entitled to keep the vehicle as an innocent purchaser under English legislation.

The minority held that there had been a meeting of the minds between Shogun and the fraudster despite the fact that Shogun was mistaken about the identity of the fraudster. In other words, Shogun had authorized the vehicle dealer to hand over the vehicle to the fraudster and intended to sell it to that person. The mistaken belief in the fraudster's identity did not negate the intention to contract. With the contract between the fraudster and Shogun upheld, the minority of the court held that Mr Hudson was entitled to keep the vehicle as an innocent purchaser under English law.

Questions for Discussion

1. Do you think that the decision of the majority of the court is fair to Mr Hudson?

2. Setting aside your views about the fairness of the decision to Mr Hudson, if you were working at Shogun, what measures might be implemented to prevent this kind of fraud from occurring in the future?

Mistake about Subject Matter Some mistakes put the parties at cross-purposes and therefore prevent the formation of a contract. This often occurs when the parties are mutually mistaken about the subject matter of an agreement. Suppose you enter a contract to buy cotton that will arrive on a ship called the *Peerless*, which you believe will arrive in October. However, neither you nor the seller knows that there is actually more than one ship called *Peerless*, one set to arrive in October and another in December. The seller, not knowing of the earlier ship, sends the cotton on the later ship. By the time the cotton arrives, you no longer have a use for it and refuse to purchase it.

In the circumstances, there was a mutual mistake about a material issue—which *Peerless* the cotton was to be shipped on—which prevented a true agreement or the creation of a contract.

18. These facts are derived from *Raffles v Wichelhaus* (1864) 159 ER 375.

Mistakes Rendering Impossible the Purpose of the Contract

Even if a mistake does not pertain to the process of contract formation, it may be relevant if it makes the contract impossible to perform. We will consider one possibility and another related scenario: (i) mistake about existence of the subject matter, and (ii) frustration.

Mistake about Existence of the Subject Matter

The parties' mistake may render the contract impossible to perform. In this situation, both parties make the *same* mistake, which is usually based on a false assumption. Suppose you agree to lease your beach house to me for the summer. We draft a contract, sign it, and exchange keys for money. The next day, however, we learn that the house had been completely destroyed by a fire a week earlier. Consequently, when we created our contract, we both made the same mistake—we believed that the house existed and that our agreement could be performed. The contract is therefore defective. You have to return my money, and I have to return your keys. And neither one of us can sue to enforce the deal.

However, a common mistake about the existence of the subject matter of a contract does not *always* prevent the enforcement of the agreement. A business should therefore protect itself by inserting into the contract a *force majeure*, or "irresistible force," clause, which states which party bears the hardship if the subject matter of the contract is destroyed or if some other unexpected event occurs. The affected party should then arrange insurance against the potential loss.

The Doctrine of Frustration

We have considered situations involving a mistake about an existing fact. Sometimes, however, the parties may make a mistake about the *future*. Even if they are fully informed when they create their contract, subsequent events may make it impossible for them to perform as anticipated.

Going back to our earlier example, I agree to rent your beach house for the summer. We create a contract and exchange keys for money. At that time, the building is in excellent shape. During the spring, however, it is completely destroyed by a fire. I could still occupy the empty lot for the summer, but that is not what we had in mind. The purpose of our agreement has been *frustrated* by an unexpected occurrence. A contract is **frustrated** when some event makes performance impossible or has the effect of radically undermining its very purpose.

a contract is **frustrated** when some event makes performance impossible or radically undermines the purpose behind the agreement

It is important to note that a contract is not frustrated merely because it becomes more expensive or somewhat more difficult to perform. For instance, our agreement would still be effective even if, because of heavy rains, you were required to spend a considerable amount of money cleaning up the beach house to make it fit for habitation during the summer. In some cases, an agreement will still be effective where performance of the contract is still possible, but slightly delayed due to circumstances beyond the control of both parties. For example, in a contract for a six-day guided wilderness tour, a court has held that no frustration takes place when an airline cancels flights because of terrorist attacks (delaying the arrival of the guest) in circumstances where the guest can arrive two days later and the guide offers to take the guest on the tour two days later than originally planned.

19. See *Allen v. Taku Safari,* 2003 B.C.S.C. 516.

The doctrine of frustration, like the law of mistake, tries to strike a fair balance between the parties. Ultimately, however, it requires a decision about who will bear the risk of a loss. In some situations, the parties themselves supply the answer.

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. For instance, I would not be entitled to a refund if I carelessly burned the beach house down during the first night of my stay.

Even if neither party is at fault, they may have agreed that one of them would bear the risk of loss. For instance, as a business that is aware of potential risks, you may have inserted a *force majeure* clause into our agreement. If so, I could not demand a refund of the rent even though the house is gone.

If the parties themselves cannot settle the issue in some way, a judge must do so. First, however, we must draw a distinction between provinces that use the common law rules and those that have legislation on point. Common law jurisdictions use an all-or-nothing rule. A purchaser can recover *all* of its contractual payments if it has not received *any* benefit from the seller. However, if the purchaser has received *some* benefit, it cannot recover *any* payments. In neither event can the seller actually demand payment from the purchaser, even if the seller incurred substantial expenses under the agreement.

20. Legislation has been enacted in Alberta, British Columbia, Manitoba, Newfoundland, New Brunswick, Ontario, and Prince Edward Island.

In other jurisdictions, the effect of the legislation turns upon the existence of a contractual payment or a benefit.

If the purchaser paid an advance or a deposit under the contract, the court has discretion to divide that money between the parties as it sees fit. Consequently, if the seller incurred some expense under the contract, it may be entitled to retain an appropriate amount as compensation. In other circumstances, the purchaser may be entitled to a complete refund.

If the purchaser received some benefit from the seller, the seller is entitled to either retain money that it has received or make a fresh claim for compensation against the purchaser. That compensation, however, cannot exceed the value of the benefit.

If the purchaser neither paid money nor received a benefit under the contract, the entire burden of the frustrating event falls on the seller. In that situation, the seller cannot claim compensation, regardless of how much expense it incurred under the agreement.

21. An exception exists in British Columbia, where the seller can claim compensation for half of its expenses.

Documents Mistakenly Signed

Another type of mistake occurs when a person signs a contractual document in error. As a general rule, that sort of mistake is irrelevant. A person is usually bound by a signature, even if they did not read the document. The other party is normally entitled to assume that a signature represents an acceptance of the agreement. There are, however, exceptions to that rule. As we saw in Chapter 9, unusual or onerous terms are not binding unless they are reasonably drawn to the attention of the person who signed the contract. There is another exception—*non est factum*.

Non est factum, literally “this is not my deed,” allows the mistaken party to avoid any obligations under the contract. The plea is available only if there is a *fundamental, total or radical difference* between what a person signed and what that person thought they were signing. This is a high threshold and will rarely be met. It may happen if the document was presented as a sale of land, when it was actually a purchase of shares. However, if the issue is merely misrepresentation, then the contract may only be voidable, not void. Similarly, the doctrine does not apply if the difference is merely a matter of degree. Consequently, a signatory cannot plead *non est factum* simply because they were mistaken about the quantity of goods that were sold under the contract. Furthermore, the doctrine cannot be used by someone who, through carelessness, failed to take steps to understand the document. This means that the

doctrine cannot be used by someone who could read a contract but did not because his glasses were broken at the time. It may also mean that someone who cannot understand a contract in English, but who could have asked a friend to translate, cannot rely on *non est factum*.

non est factum literally means “this is not my deed”

Unfairness During Bargaining

As we saw in the discussion on incapacity, weaker parties are not always required to complete their agreements. If a disadvantaged party is pressured into an agreement or placed in an unfair position during the bargaining process, the contract may be ineffective. We conclude this chapter with a brief examination of three types of unfair bargaining: duress, undue influence, and unconscionable transactions.

Duress

Duress of person refers to physical violence or the threat of violence against a person or that person’s loved one. If a contract is the product of duress, it is *voidable*. The innocent party may choose not to perform and recover any payments they made under the agreement. Similar rules apply to *duress of goods*. **Duress of goods** occurs when one person seizes or threatens to seize another person’s goods to force that person to create a contract. The innocent party can avoid the contract if they can show that the pressure was practically irresistible.

duress of person refers to physical violence or the threat of violence

duress of goods occurs when one person seizes or threatens to seize another person’s goods to force that person to create a contract

Fortunately, the courts seldom hear cases involving duress of person or of goods. Unscrupulous business people do, however, occasionally resort to a more subtle form of pressure—*economic duress*. **Economic duress** arises when a person enters into a

contractual arrangement after being threatened with financial harm. For example, a contractual party, claiming that the cost of performance is higher than expected, indicates that it will not fulfill its obligations unless it receives additional money.

economic duress arises when a person enters into a contractual arrangement after being threatened with financial harm

Economic duress is more difficult to determine than duress of person or duress of goods. It is always wrong to put a gun to someone's head; it is not always wrong to exert economic pressure over them. Indeed, that sort of thing regularly happens in the business world. Courts look at several factors before determining that a pressure was a threat.

Economic pressure is more likely to be considered illegitimate if it was made in *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 victim of the pressure must show that they *could not have reasonably resisted*. Sometimes, it is reasonable to resist by bringing the matter to court; sometimes the situation requires a much quicker response.

The courts are more sympathetic if the victim started *legal proceedings promptly* after the effects of the pressure passed.

The courts are more likely to become involved if the victim *protested* when presented with the pressure. However, a failure to protest is not necessarily fatal if that course of conduct was obviously futile in the circumstances.

A contract is more likely to be considered voidable if the victim *succumbed to the pressure without legal advice*; otherwise, agreement to a contractual proposal tends to look more like a sound business decision.

Undue Influence

Even if the elements of common law duress cannot be established, relief may be available under such equitable principles as *undue influence*. **Undue influence** is the use of any form of oppression, persuasion, pressure, or influence—short of actual force, but stronger than mere advice—that overpowers the will of a weaker party and induces an agreement. Cases involving undue influence are usually one of two types: where the parties are in a *fiduciary relationship*, and where there is no special relationship between the parties. Figure 10.1 illustrates the differences.

undue influence is the use of pressure to overpower the will of a weaker party and induce an agreement

[[Pick up Figure 10.1, including label and background text, from p. 115. Formerly Fig. 5.1.]]

Figure 10.1 Undue Influence

A **fiduciary relationship** is one in which one person is in a position of dominance over the other. That power imbalance usually exists in a relationship that is based on trust or confidence. Fiduciary relationships generate a special kind of duty that requires the more powerful party to subordinate its personal interests in favour of the weaker party. Whenever parties in a fiduciary relationship enter into a business transaction, there is good reason to suspect undue influence on the part of the more powerful party. For this reason, the law imposes a *presumption of undue influence* whenever a fiduciary is involved in a transaction.

a **fiduciary relationship** is a relationship in which one person is in a position of dominance over the other

Not every transaction involving a fiduciary is defective, and the presumption of undue influence can be rebutted. If the fiduciary can prove that the transaction was fair, the contract will stand. Often, the best tactic for a fiduciary is to ensure that the other party receives independent legal advice before entering into the agreement.

The second type of undue influence scenario arises when there is no special relationship between the parties. In such a case, there will be *no presumption* of undue influence. The party seeking relief from such a contract must prove that undue pressure was applied. When a business is not in a position of domination, it will be much harder for the other party to have the transaction set aside for undue influence. As a matter of risk management, a business can avoid that possibility by refraining from using bullying tactics and, in appropriate circumstances, by suggesting independent legal advice.

Unconscionable Transactions

Equity also provides relief from *unconscionable transactions*. An **unconscionable transaction** is characterized by its one-sidedness. It is an agreement that no right-minded person would ever make and no fair-minded person would ever accept. The weaker party must prove (i) that there was an **improvident bargain**, one that was made without proper regard to the future, and (ii) that there was an inequality in the bargaining position of the two parties. (Figure 10.2 distinguishes the differences.) If those elements are satisfied, the court presumes that the transaction was unconscionable. The stronger party must then rebut the presumption of unconscionability. Even if the contract does not provide a benefit for the weaker party, the agreement may stand if the stronger party shows that the bargaining process was fair, right, and reasonable after all. As usual, the risk can be managed, most notably by ensuring that the weaker party receives independent legal advice. Ethical Perspective 10.1 illustrates the problem.

an **unconscionable transaction** is an agreement that no right-minded person would ever make and no fair-minded person would ever accept

an **improvident bargain** is a bargain made without regard to one’s future

22. See *Turner Estate v Bonli Estate* [1989] SJ No 342 (Sask QB), aff'd [1990] SJ No 313 (Sask CA).

Several provinces have legislation governing unfair transactions. Some is preventive, using such devices as disclosure requirements or "cooling-off" periods to reduce the risk of a stronger party taking advantage of a weaker one. Other statutes prohibit the use of particular unfair terms, such as exclusion or forfeiture clauses. Still other statutes give the court a broad discretion to render harsh or unconscionable agreements ineffective, typically in legislation regulating money lending institutions and insurance companies.

23. *Consumer Protection Act*, RSBC 1996, c 69, s 11 (BC); CCSM c C200, s 62(1) (Man); RSO 1990, c C31 s 21 (Ont); *Direct Sellers Act*, RSNB 1973, c D-10, s 17 (NB).

24. *Consumer Protection Act*, RSM 1987, CCSM c C200, s 58 (Man); RSO 1990, c C31, s 34 (Ont); *Sale of Goods Act*, RSBC 1996, c 410, s 20 (BC).

25. *Money-lenders Act*, RSNS 1989, c 289, s 3 (NS); *Unconscionable Transactions Act*, RSA 2000, c U-2, s 2 (Alta); *Insurance Act*, RSO 1990, c I.8 (Ont); RSPEI 1988, c I-4, s 92 (PEI); RSNWT 1988, c I-4, s 46 (NWT).

[[Pick up Figure 10.2, including all label and background text, from p. 117. Formerly Fig. 5.2.]]

Figure 10.2 Unconscionability

Ethical Perspective 10.1

Beach v Eames (1976) 82 DLR (3d) 736 (Ont Co Ct)

Mr Beach was lying on his chesterfield with his legs propped up on pillows when Mr Pyatt, an insurance adjuster, unexpectedly showed up at his house. Beach was suffering the effects of a car accident, which had occurred a month earlier. Although he

had missed several weeks of work because of his injuries, Beach had not yet seen his doctor or his lawyer, nor had he consulted with his own insurance agent.

Pyatt quickly and accurately sized up the situation. He knew that Beach had limited education and modest mental abilities. He also knew that Beach trusted him. Pyatt seized the opportunity and offered to settle, for a payment of $500, any potential claims that Beach might enjoy under his insurance policy. Beach agreed and signed the document, not realizing that his injuries might be worse than he suspected but not worse than Pyatt suspected.

Beach eventually realized that his injuries were very serious and that he had agreed to a very bad deal. He therefore sued to set aside the settlement contract.

Questions for Discussion

1. Did the insurance adjuster do anything wrong or was he just doing his job? Explain.

2. If you owned the insurance company, how would you respond to this incident?

3. If you were the judge in this case, how would you respond to this incident?

Illegality

A contract may be ineffective because it violates the law. There are several variations on that theme. **Illegal agreements** are expressly or implicitly prohibited by statute and are therefore void. Other agreements, though not strictly prohibited, come into conflict with a common law rule or offend public policy. They too are often unenforceable.

illegal agreements are expressly or implicitly prohibited by statute

Agreements Prohibited by Statute

Most statutes that prohibit particular types of agreements are *regulatory* in nature. The purpose of a **regulatory statute** is not to punish individuals for wrongdoing but rather to

regulate their conduct through an administrative regime. For example, there are statutes that prohibit the sale of apples that have not been graded in accordance with provincial regulations. Other statutes require licences to be obtained prior to engaging in certain kinds of transactions.

the purpose of a **regulatory statute** is not to punish individuals for wrongdoing but rather to regulate their conduct through an administrative regime

26. *Kingshott v Brunskill* [1953] OWN 133 (CA).

Common Law Illegality

Some agreements are illegal even if they do not contravene a particular statute. The common law is unwilling to recognize agreements that are contrary to public policy. For example, a mobster may hire a thug to kill a politician. If the thug decides instead to take the money and run, the mobster cannot sue for breach of contract. The same is true of any agreement that is aimed at committing a crime or a tort.

The common law will not recognize several other types of agreement, including those that are damaging to a country's safety or foreign relations, that interfere with the administration of justice, that promote corruption, and that promote sexual immorality. Each type of agreement is contrary to public policy.

The Doctrine of Public Policy

It may seem odd that a court can strike down a contract simply because it is contrary to public policy. After all, the law of contract is intended to facilitate stable and predictable business relationships by allowing people to freely enter into whatever bargains they choose. The notion of public policy, however, is notoriously vague. It may also allow judges to make or unmake contracts on the basis of their own personal views as to what is best for society. Public policy, according to an old saying, becomes "an unruly horse" if it is let out of the barn.

Covenants in Restraint of Trade

An agreement may be ineffective on the grounds of public policy if it contains a *covenant in restraint of trade*. A **covenant in restraint of trade** is a contractual term that *unreasonably restricts* one party's liberty to carry on a trade, business, or profession in a particular way. Such covenants often require a person to (i) trade or *not* trade with someone in particular, or (ii) work for someone in particular or, at least, *not* work for anyone else. In its most unreasonable form, a broadly drafted restraint of trade provision comes close to slavery. In that situation, the covenant will be presumed contrary to public policy unless the party seeking to enforce it can demonstrate that the restriction is reasonable. However, even if an unacceptable provision is struck down, the rest of the contract may remain.

a **covenant in restraint of trade** is a contractual term that *unreasonably restricts* one party's liberty to carry on a trade, business, or profession in a particular way

Many restrictive covenants are perfectly reasonable and therefore not contrary to public policy. Suppose you are thinking about buying a convenience store. You may legitimately insert a provision into the contract that prevents the current owner from opening or operating another convenience store within a six-block radius. That provision merely ensures that the current owner does not steal all of your expected customers. It would be different, however, if the contract prohibited the current owner from operating another convenience store *anywhere* in Canada. A convenience store in another neighbourhood, let alone another city, does not create a threat to your business. The contractual term would therefore be an unreasonable restraint of trade, contrary to public policy, and hence ineffective.

Restraint of trade clauses are often found in employment contracts. As a matter of risk management, employers should consider drafting such provisions as narrowly as possible to achieve the desired goals while maximizing the likelihood of enforcement. This issue is discussed in more detail in Chapter 26.

Chapter Summary

A contract may be defective due to (i) incapacity, (ii) absence of writing, (iii) mistake, (iv) frustration, and (v) unfairness during bargaining.

A contract cannot normally be created by a person who lacks the legal power of consent. With the exception of a limited class of contracts concerning employment and the purchase of necessaries, a minor's contracts are voidable. Similarly, an agreement created by a mentally incapacitated adult may be set aside. Intoxicated persons who seek to avoid contractual liability can only do so if they can prove that they were incapable of knowing or appreciating what they were doing, and that the other party was aware of this incapacity. A statutory corporation, unlike a chartered corporation, has a limited contractual capacity. Although associations are generally incapable of contracting, some provinces have enacted legislation that enables associations involved in specific purposes to enter into contracts. Generally, a public authority acting within its powers has the capacity to contract independent of any specific statutory authority to do so.

The *Statute of Frauds* requires the party seeking to enforce contracts such as guarantees, contracts for the sale of an interest in land, and contracts not to be performed within a year, to adduce evidence in the form of a written and signed memorandum or note. Some consumer protection laws contain similar requirements that certain agreements be made in writing, with a copy provided to consumers.

A mistake can interfere with the parties' attempt to reach an agreement or make it impossible for the object of the contract to be achieved. A mistake of identity or a material mistake about the terms of a contract may preclude its formation if the mistake is known to the other party. A material mistake about the subject matter of a contract may also negate consent. A common mistake about the existence of the subject matter renders it impossible for a contract to be fulfilled and will sometimes operate as a defence. A mistaken assumption that one or both parties make about the future can result in frustrating a contract. A contract is frustrated when some event occurs that makes further performance of the contract impossible or radically undermines its very purpose.

When a party is pressured into an agreement or placed in an unfair position during the bargaining process, the agreement may be defective. Economic duress arises when a party enters into a contractual arrangement after being threatened with financial harm. Undue influence occurs when pressure is exerted by a stronger party to overpower the will of a weaker party and thereby induce an agreement. The law imposes a rebuttable presumption of undue influence whenever a fiduciary is involved in a transaction. The presumption is usually rebutted if the stronger party shows that the weaker party had the opportunity to seek independent advice. An unconscionable transaction is an agreement that no right-minded person would ever make and no fair-minded person would ever accept. Although it is generally up to the parties to make their own bargains, courts will interfere if a contract was the result of duress, undue influence, or unconscionability.

Illegal agreements are those that are expressly or implicitly prohibited by statute. Illegal agreements, along with other agreements that come into conflict with a common law rule or public policy, are often unenforceable. An example of an agreement that conflicts with public policy is a covenant in restraint of trade, which is enforceable only if it is reasonable.

Review Questions

1. What is meant by the term “contractual capacity”?

2. Why are some contracts entered into by a minor voidable? What is an election, and when must it be made?

3. Give examples of contracts that will be enforced even if a person has not attained the age of majority.

4. Compare the legal effect of a contract entered into by a mentally disabled adult and a contract entered into by a minor.

5. Describe a situation that would lead a court to allow an intoxicated person to avoid contractual liability.

6. Explain how the contractual capacity of a chartered corporation differs from that of a statutory corporation.

7. Why must a business person be particularly careful when contracting with or on behalf of an association?

8. Do Indian bands have the legal capacity to contract? Under what circumstances do Aboriginal persons have the capacity to contract? Explain.

9. What is the difference between a guarantee and an indemnity?

10. Does the *Statute of Frauds* have effect throughout Canada? Briefly explain the rationale for the writing requirement.

11. Outline the writing requirements typically stipulated by a *Statute of Frauds*.

12. If a contract does not comply with the *Statute of Frauds*, making it unenforceable, does it follow that the agreement has no legal effect? Explain your answer.

13. Outline the difference between mistakes preventing the creation of contracts and mistakes that make it impossible for the object of a contract to be achieved. Provide examples of each.

14. How might a case of mistaken identity provide a contractual defence?

15. Explain the doctrine of frustration. What are its effects?

16. What is the difference between common law and statutory approaches to the doctrine of frustration?

17. Explain why the plea of *non est factum* is part of the law of mistake.

18. What is a restrictive covenant? How is it relevant to the doctrine of public policy?

19. Outline three bases upon which a court might set aside an unfair contract. Is there a common thread underlying the rationale in each?

20. Explain the basic characteristics of a fiduciary relationship. Give examples.

Cases and Problems

1. Erin had always been independent. Shortly before her seventeenth birthday, she moved out of her parents' house and bought a used car, which she needed for her fledgling chocolate-covered-cranberry enterprise. She agreed to pay $15 000 for the car, $5000 as a down payment and the rest in monthly instalments over one year. She used the car mostly to make deliveries and to pick up supplies. After she drove the car for three months, the bearings burnt out. Since Erin was in a position to hire a delivery person, she decided that she no longer wanted the car. Having studied the basics of contract law in high school, Erin attempted to return the vehicle to the car dealership, claiming that she had elected to avoid the contract. The dealership refused, having received an opinion from its lawyer that a contract for necessaries is enforceable against a minor. Erin replied that the car was not a necessary, and that the contract was therefore not enforceable. Do you think that Erin will be permitted to avoid her contract with the dealership? Give reasons to support your position.

2. Elwood is a pig farmer who is known to enjoy a drink or two. One day in July, after a weekend of particularly heavy drinking, he staggered into the office of Pork Bellies of America and offered to sell all of his piglets. He promised to deliver them in October, as soon as they were fattened up. Hank, Pork Bellies' purchasing agent, saw that Elwood was extremely drunk, but decided to write up the contract anyway since the price was a fair one. After the deal was signed, Hank and Elwood went to the neighbourhood saloon to play darts and have lunch. The next day, after sobering up, Elwood was reminded about their agreement. In fact, over the course of the next two weeks, Hank and Elwood ran into each other on a number of occasions. Each time, Hank mentioned the deal, and Elwood acknowledged it. In September, the price of pork nearly doubled. Consequently, Elwood sent Pork Bellies of America a registered letter saying that he would not be delivering the pigs. He had decided to sell them to someone else at a higher price. Pork

Bellies has sued Elwood. Will the court allow Elwood to avoid contractual liability? Give reasons to support your position.

3. Michel is a 22-year-old man who has been declared mentally incompetent. He can barely read or write and has an IQ of 41. Nevertheless, he executed a deed of conveyance transferring his proprietary interest in his late father's farm to his stepmother, Paula, in exchange for a small annual payment. Without providing much in the way of detail, Michel told his legal guardian about signing the papers and giving them to Paula. Michel's guardian quickly made an application to the court to set aside the deed and the agreement. The guardian freely admits that the price agreed to is fair and that Paula was not intent on fraud. Is the agreement between Paula and Michel enforceable? Would your answer be different if Paula were not related to Michel and did not know about his condition?

4. The general manager of Nunzio's Kosher Pizzeria has hired you to wash dishes in the evening. On your third shift, you are finally introduced to Nunzio. He seems like a nice guy as he welcomes you aboard. You are paid weekly by a cheque drawn from the account of a numbered company called 551999 Alberta Ltd. Nunzio's name is one of the two signatures on the cheques. Things go well for the first two months. Then you are not paid for three weeks in a row. The following week, the pizzeria is shut down. After finding out that the numbered company has gone bankrupt, you see your lawyer about suing Nunzio personally. After reviewing the corporate records, your lawyer tells you that there has been a mistake of identity—your employment contract was with the numbered company, but Nunzio is neither an officer or shareholder in that company. What does your lawyer mean by mistaken identity, and how will it apply in your case?

5. Fedor's law firm represents the Hole-In-One Mini Donuts Co. While doing some legal work for the company, Fedor discovers that the Hole-In-One no longer owns any assets. Rodya and Philka, the two corporate shareholders, verbally assure Fedor that they will not only answer for the legal fees already incurred by the corporation but will also take responsibility for any and all future charges. Although Fedor accepts this proposal, he does not require it to be put into writing. On the faith of their promise, the law firm

continues to do work for the corporation. Fedor sends another bill to Hole-In-One, knowing full well that the corporation is unable to pay. Shortly thereafter, Fedor commences an action against Rodya and Philka. The defendants claim that their promise is unenforceable because it was not in writing. How would you respond to that argument?

6. In January 2001, Allen entered into a contract with Taku Safari and paid a deposit of $3000. Under the contract, Taku was to take Allen on a six day backcountry adventure in Alaska between September 15 and 21, 2001. Allen was to fly to Juneau, Alaska on September 14 where Taku's float plane would take him to the backcountry. On September 14, Allen learned that his flight had been cancelled and rescheduled for September 16 in the wake of the terrorist events of September 11, 2001. Taku told Allen that it could not guarantee that its float plane would be available on September 16 but that Allen should get to Juneau as soon as possible. Taku told Allen that he would get a full six-day tour even if he arrived on September 16, or afterwards. Thus, Taku indicated that it could perform the contract, although performance would be delayed due to Allen's late arrival. Allen was not willing to fly to Juneau on September 16 without a guarantee that the float plane would be available on that date. He told Taku that he was cancelling the trip and that he wanted his deposit back. Allen claimed that the doctrine of frustration applied because the terrorist events of September 11, 2001 led to the rescheduling of his flight to Juneau and prevented performance of the contract for a tour from September 15–21, 2001. The contract was silent about who bore the risk of loss in this kind of situation and did not contain a *force majeure* clause. If you were the judge deciding this case, would Allen be successful in invoking the doctrine of frustration? Why or why not?

7. Several years back, Golden Joe's Geology bought a 1000-acre package of land in the Northwest Territories. When he purchased the property, Joe was sure to purchase the mineral rights as well. For years, Joe spent his summers panning for gold on the property. Recently, quite by accident, Joe discovered that his land is at the heart of a potentially lucrative diamond stash. Joe is overjoyed and has decided to sell his property so that he can retire to a tropical locale. He has agreed to sell the property and

mineral rights to Prospectus Prospecting, which will invest the money needed to mine and process the diamonds. The agreement is drawn up and signed by both parties, and everyone is satisfied. However, when the actual land transfer is about to take place, it is discovered that the Crown grant of property to Joe has been substantially revoked. As a result, the land available for sale is in fact reduced by 90 percent. Is Joe still entitled to performance of the contract with Prospectus? Explain why or why not. As a prudent business manager, could Joe have better protected himself against such a possibility? Explain how.

8. Edmond is the first mate on an old fishing trawler in Nova Scotia. Go Fish Inc has just purchased and outfitted a new vessel and wants to hire Edmond as its captain. The president of Go Fish Inc offers Edmond the job and, as an inducement, gives him a $10 000 loan. According to the terms of their arrangement, $3000 of the loan will be forgiven once Edmond completes the new vessel's maiden voyage as captain. Two days after the maiden voyage, Edmond suffers a long-term disability and is told that he might not be able to sail ever again. He phones his boss to tell her that he cannot continue to fulfill his part of the bargain. The ship continues to sail without him. Go Fish Inc wonders whether it can recover the $10 000 loan and an additional sum from Edmond for breach of contract. Your business consulting firm is contacted by Go Fish Inc to provide advice. What advice will you give? How might the business manager at Go Fish Inc have avoided having to seek your advice?

9. Mr Stone has no formal education. He speaks English and has worked as a labourer and a truck driver in Canada for 20 years. Mr Stone recently decided that he wanted to start a business of his own. He sought a loan for his business from $peedy Financial $ervices (SFS). SFS loaned Mr Stone's business $80 000 and required Mr Stone to sign a personal guarantee for all of the business's future obligations to SFS. SFS's loan officer explained the significance of the personal guarantee to Mr Stone. The loan officer spoke Punjabi and English with Mr Stone when arranging for the loan and the personal guarantee. However, all of the documentation was written in English. Mr Stone's company later became indebted to SFS and SFS sought to collect the debt from Mr Stone based on the personal guarantee. Mr Stone has raised the defence of

non est factum. He admits that he knew that he was signing documents to facilitate a loan to his company, but he claims that he was not aware that he was signing a personal guarantee for the debts of his company, thereby creating a personal liability to SFS. He claims that no one at SFS told him to read the documents, and that even if he had read them, he would not have understood most of them because he could not read English well. Mr Stone made no inquires of anyone and asked no questions to determine what he was signing when he signed the personal guarantee. SFS is concerned that it may not be able to collect the debt from Mr Stone given that he did not read the document and can't read English well. You work at SFS and have been asked to assess whether Mr Stone's *non est factum* defence might be upheld by a court, including the reasons why or why not.

10. Mind Games Inc hires CompuNerd to overhaul its entire computer network for a flat fee of $350 000. Marinka, Mind Games Inc's general manager, stresses that the computer upgrades must be finished by the end of July so that there is enough time for Mind Games Inc to complete a large consulting project before its fall deadline. Marinka explains to CompuNerd that a failure to meet these deadlines would cause Mind Games Inc severe financial hardship. From the start, the computer overhaul seems jinxed. Due to several delays, the software upgrades are not quite half finished by the beginning of August. Bernie, the nerd in charge of the upgrades, meets with Marinka that afternoon. He claims that the delays were unavoidable and that CompuNerd is incurring unexpected costs. He insists on renegotiating their agreement to include additional payment for "time and materials." He threatens Marinka by saying that, unless she agrees to the new terms, he will reduce his staff by half. Marinka realizes that such a reduction would mean that the computer upgrades would not be completed for two additional months. Finding herself in a serious bind, Marinka reluctantly agrees to alter the terms of the original flat-fee contract to include additional payment for time and materials. But after the job is finished, Mind Games Inc pays only the originally agreed upon amount. CompuNerd sues to recover the amount owing under the renegotiated terms. Marinka asks you to determine whether Mind Games Inc is obligated to pay the additional amount. How did you arrive at your conclusion?

11. Coby and Maya immigrate to Canada. Unlike her doctor husband, Maya speaks no English and misses her friends and family terribly. She becomes depressed. Her husband, Coby, prescribes an antidepressant in ever-increasing dosages. Eventually, the couple separates. Maya continues to take her medication. They enter into a separation agreement whereby Coby pays Maya support, but the monthly sum barely covers her rent and living expenses. During divorce proceedings, Maya claims that she was forced into the separation agreement by her overbearing husband and that she was heavily sedated at the time. What is the legal basis of her claim? What must her husband prove to ensure that the separation agreement contract is enforceable?

12. In 1975, Oli Bonli was 88 years old. He owned some land which he agreed to lease to Mr Turner for five years with an option to purchase the land when the lease expired. The purchase price for the land at the end of the five-year lease term was set at $100 000, payable over 20 years at $5000 per year. No interest was payable under the agreement. In fact, the value of the land in 1975 was $167 000, much higher than the purchase price. Land prices in the area were skyrocketing at this time and Mr Turner knew it. At that time, Mr Turner was 47 years old and he personally drafted a written contract on the terms agreed to. He had Mr Bonli come to his office to sign the contract at 7:00 a.m. when no one was likely to be around. Mr Bonli did not obtain independent legal advice before entering into the contract. Despite being a longtime farmer on the same piece of land, Mr Bonli made two errors in the legal description of his land on the contract. At that time, age was catching up to Mr Bonli—he had good days and bad days when he was very confused. Very shortly after signing the contract, Mr Bonli denied that he had sold his land and told someone that he thought he had actually *bought* land from Mr Turner. In 1976, Mr Bonli was taken to a nursing home as he could no longer care for himself properly. By the end of the lease term in 1980, the value of Mr Bonli's land had risen to $418 000. Mr Turner then sought to exercise his option to purchase the land for $100 000 pursuant to the payment terms of the contract. Mr Bonli's estate refused to sell the land to Mr Turner, claiming that the contract was unconscionable. If you were the judge deciding this case, would you find the contract to be unconscionable? Why or why not?

WWWeblinks

Contract Law

www.duhaime.org/ca-con1.htm

This page provides an introduction to various areas of contract law, including offer and acceptance, privity, mistake, misrepresentation, breach, and remedies. The site also offers summaries of leading case law.

Contracts Canada

http://contractscanada.gc.ca/en/index.html

This site offers information on how the federal government conducts business with its suppliers, including government purchasing and government contacts.

Ontario *Statute of Frauds* RSO 1990, c S-19

www.e-laws.gov.on.ca/DBLaws/Statutes/English/90s19_e.htm

This Statute is representative of provincial legislation that sets out the types of contracts that must be evidenced in writing.

British Columbia *Frustrated Contract Act***, RSBC 1996, c 166**

www.qp.gov.bc.ca/statreg/stat/F/96166_01.htm

This Act applies to contracts that are discharged by reason of the application of the doctrine of frustration.

Additional Resources for Chapter 10 on the Companion Website (www.pearsoned.ca/mcinnes)

In addition to self-test multiple-choice, true-false, and short essay questions (all with immediate feedback), three additional Cases and Problems (with suggested answers), and links to useful Web destinations, the Companion Website provides the following resources for Chapter 10:

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