

**Assignment extract:**

Morris sold his photocopying and laminating business for \$95,000 to Beth. Because Beth did not have the money to pay cash, Morris agreed to an immediate payment of \$35,000 with the balance payable out of future profits over the next three (3) years. In the first six (6) months the business did well and Beth was able to pay Morris a further \$5,000. A competitor then opened nearby. This competitor was part of a well-known chain of photocopying shops and as such had access to cheap overseas supplies of laminating and copying materials. Consequently, the competitor was able to undercut Beth's business. Beth's profits fell alarmingly. Beth advised Morris that financially she could no longer continue with the agreement and would have to close the business. Further, she accused Morris of knowing that the competitor was about to open up and therefore she was commencing legal action to rescind the contract based on fraudulent misrepresentation. Morris contacted Beth and made the following comments: "I absolutely deny your accusation. By my reckoning you still owe me \$55,000. However, if you continue with the agreement I'll reduce that amount to \$35,000." Beth accepted the deal. Six (6) months later Beth landed a huge contract laminating all the posters for a chain of tourist attractions along the north coast of New South Wales. Beth's profits have soared. Morris is now demanding that the original contract price be complied with (i.e. Beth pays the remaining \$55,000).

**[Part A]**

**Is Beth liable to pay the original contract price?**

Under classical contract theory, consideration is necessary for a contract to be enforceable. In order to meet the requirements for consideration, a contract must fulfill three elements. First, there must be a bargain regarding terms of an exchange. Second, there must be a mutual exchange. In other words, both parties must get something out of the contract. Third, the exchange must be something of value. Initially, the present case seems to fulfill all the three requirements. However, the contract lost its third element of consideration, i.e. the business bought by Beth turned non-profitable to Beth as a competitor emerged, who was able to offer services at cheap rates. This amounted to a

“frustration of purpose”<sup>1</sup> and renders it commercially impracticable for Beth to continue with the contract. At this point Beth advises Morris that financially she could no longer continue with the agreement and would have to close the business. Furthermore, she accused Morris of knowing that the competitor was about to open up and therefore she was commencing legal action to rescind the contract based on “fraudulent misrepresentation”.

However, she decides to continue with the contract when Morris’ reduces the amount to \$35,000. But invoking the law on grounds of fraudulent misrepresentation would have been quite difficult for Beth. Nowhere it is mentioned that Morris portrayed his printing business as profitable to Beth. Fraudulent misrepresentation is when the representation is made with intent to deceive and with the knowledge that it is false. Also, Morris’ comments needs to be taken into account—

“I absolutely deny your accusation...”

Yet, Morris reduces the amount to \$35,000 provided Beth continues with the contract,

“...However, if you continue with the agreement I'll reduce that amount to \$35,000.”

Indeed, there was an initial agreement that the balance is payable out of “future profits” over the next three years, and since profits were diminishing, Morris reduces the amount. Although this doesn’t amount to a new contract, yet it’s an agreement whereby Beth is required to pay a reduced amount. Now, after six months when Beth strikes a huge contract and her profits soar, Morris cannot enforce the original contract. It would be highly unfair for Morris to change his mind over time.

If Morris invokes the law, his appeal is likely to be dismissed and promissory

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<sup>1</sup> Frustration of purpose is a term used in the law of contracts to describe a defense to an action for non-performance based on the occurrence of an unforeseen event which makes performance impossible or commercially impracticable. Generally it is not excused.

estoppel<sup>2</sup> be granted in favor of Beth. The doctrine of *promissory estoppel*<sup>3</sup> prevents one party from withdrawing a promise made to a second party if the latter has relied on that promise and acted upon it. Indeed, Beth had acted upon Morris's promise that he had reduced the amount to \$35,000. She continued with the contract and did not rescind it or sue Morris on grounds of fraudulent misrepresentation (in that case, the situation would have been totally different). Based on these facts, it may well be concluded that Beth is not liable to pay the original contract price.

### **Part B]**

#### **Discuss whether this situation would differ in any way if Morris were the uncle of Beth.**

As per law of contract in common law jurisdictions, where an agreement is reached between family members or friends in a domestic context, then the presumption is that there is no intention to create legal relations. So, if Morris were the uncle of Beth, one can presume that a contract didn't exist at all. An often-cited case to support the presumption that domestic or family agreements do not amount to contracts is *Balfour v Balfour*<sup>4</sup>. As such, Morris cannot compel Beth to pay the original amount had he been her uncle. However, since Beth was able to make good profits, it may well be argued that she

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<sup>2</sup> The doctrine of promissory estoppel was adopted into Australian law in *Legione v. Hately* (1983) HPH 214

<sup>3</sup> Where some representation is made about future conduct, then this is either a promise or something very close to a promise. The courts of equity said that in certain circumstances a person could not depart from such a statement about the future. In other words it was binding, despite there being no consideration.

<sup>4</sup> Atkin LJ's judgment that a promise by a husband to pay his wife an allowance, even if it could be said that there is a consideration for the promise, is not binding because neither party intended that such a promise should generate legal liability. [Heffey, Paterson and Hocker (1998), Contract Commentary and Materials, 8<sup>th</sup> edition (LBC Information Services) p. 202-203]

pays the original amount to Morris on grounds of good faith, for later it's seen that there does not exist a total failure of consideration and Beth, indeed, was able to make profits from the business.

However, the Kin-selection theory identifies a basis to enforce a promise taking place within a family. Any benefit to Beth accrues to Morris, as well, for Beth is genetically part-Morris (if he were uncle of Beth) and vice versa. (Coefficient of relatedness is 0.25)<sup>5</sup>. Kin-selection is a substitute for consideration. But even if Morris is able to invoke the law, he can't enforce the initial contract amount. The business turns non-profitable to Beth and she decides to rescind on grounds of fraudulent misrepresentation. However, Morris reduces the amount and hence Beth continues with the contract. Now when Beth starts making profits Morris cannot change his mind. Promissory estoppel maybe granted in favor of Beth. Promissory estoppel prevents one party from withdrawing a promise made to a second party if the latter has relied on that promise and acted upon it. Indeed, Beth had acted upon Morris's promise that he had reduced the amount to \$35,000. She continued with the contract and did not rescind it. Based on these facts, it is unlikely that Beth can be legally pursued to pay the original contract price.

## Part C]

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<sup>5</sup> From an evolutionary perspective, the objective of reproduction is to propagate one's genes. Personal reproduction is one way to achieve this. Another is to help individuals who share the same genes. Similar genes are present not only in offspring and their parents, but in other relatives, as well. A mathematical way of representing the probability that any two relatives share the same genes is called the "coefficient of relatedness" or  $r$ . Between parent and offspring,  $r$  is 0.5; between full siblings, 0.5; between uncle/aunt and nephew/niece, 0.25; between grandparent and grandchild, 0.25; and between cousins, 0.125. *Animal Behavior*, by J. Alcock, Sinauer Associates, Fifth Edition, 1993, Pages 506-510.

**Discuss whether your answer to Part A] would differ in any way if Morris had conducted all his businesses including the printing business as Morris Pty. Ltd.?**

A contract would have still existed had Morris conducted his business as Morris Pty Ltd.

The communication would essentially have been in “trade or commerce” akin to

*Bevanere Pty Ltd v Lubidineuse*<sup>6</sup>, and hence it is enforceable in courts. The doctrine of “payment of lesser sum”<sup>7</sup> cannot support Morris, for the rule is inapplicable in this case.

Morris had reduced the amount, and thus was able to persuade Beth to continue with the contract and stop her from rescinding on grounds of fraudulent misrepresentation. Thus, Morris had availed this benefit by reducing the contract amount. It can well be compared to *Musumeci v Winadell Pty Ltd*<sup>8</sup>. Hence, under promissory estoppel, Morris would be estopped from enforcing the original contract amount.

Moreover, it can also give rise to issues of unconscionability. Section 52 of the Trade Corporations Act limits a corporation from engaging in conduct that is misleading or deceptive or is likely to mislead or deceive. Under certain circumstances, failing to

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<sup>6</sup> This was a case where a company sold its principal asset. The company was in the business of providing cosmetic services to customers. It was obviously not in the business of selling assets. So, it was arguable that this one-off sale was not in trade or commerce. But this argument was not accepted. It was held that the sale of a business asset was in trade or commerce. [Heffey, Paterson and Hocker (1998), Contract Commentary and Materials, 8<sup>th</sup> edition (LBC Information Services) p. 1103]

<sup>7</sup> The rule says that payment of a lesser sum is not a discharge of a debt. The word "satisfaction" is used in this context - payment of a lesser sum is no satisfaction of a larger debt. So, if a creditor says to a debtor that the creditor will be quite happy to accept \$80 as a discharge of a debt of \$100, this promise is not binding. The creditor can turn round a day later and sue for the unpaid \$20. But the rule will not apply if something can be found which makes up the difference.

<sup>8</sup> Heffey, Paterson and Hocker (1998), Contract Commentary and Materials, 8<sup>th</sup> edition (LBC Information Services) p. 171] In this case, Santow J applied the newly formulated consideration to the facts of this case. The landlord, in exchange for the promise of allowing the tenant to pay a reduced rent, received the practical benefit of maintaining a shopping center, which was fully let. He also said that the tenants suffered a detriment in staying on at a reduced rent because they exposed themselves to the risk of competing with the large retailer and they gave up their possibility of walking away from the lease which may not necessarily have cost them for breach because they had some counter arguments to throw at the landlord if it sued for breach.

disclose certain facts can also be construed as misleading conduct. In this case, Morris fails to disclose it to Beth that a competitor— part of a well-known chain of photocopying shops and having access to cheap overseas supplies of laminating and copying materials— is going to be opened nearby. It is a matter of common understanding that such a competitor will undercut the current business. If Beth had known this, she might not have opted for the contract at all. Unconscionability was clarified as a cause-of-action in the famous case of Amadio<sup>9</sup>. The Australian High Court held that an act was unconscionable if a party to a transaction is under a ‘special disability’, the other party is or ought be aware of that disability, and that other party acts in a way that makes it unfair or unconscionable to accept the offer of the weaker party. In this case, the following might be recognized as a valid point for unconscionability:

- ignorance of important facts known to the other party

Given Beth’s ignorance about the new competitor, it’s probable that Morris has taken advantage to sell his business in a way that is unconscionable. Thus, Beth is not liable to pay the original contract price.

#### References:

Heffey, Paterson and Hocker (1998), Contract Commentary and Materials, 8<sup>th</sup> edition (LBC Information Services)

Animal Behavior, by J. Alcock, Sinauer Associates, Fifth Edition, 1993

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<sup>9</sup> Australia: Managing Unconscionable Conduct Risk, <<http://www.mondaq.com/article.asp?articleid=4961&searchresults=1>>, accessed on 04/27/06

Australia: Managing Unconscionable Conduct Risk,  
<<http://www.mondaq.com/article.asp?articleid=4961&searchresults=1>>, accessed on  
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Kin Selection, <http://www.biojuris.com/natural/2-4-0.html>, accessed on 04/27/06

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