CONTRACTS: AN INTRODUCTION

What is a contract?

A contract is a legally enforceable understanding between two or more persons or legal entities (the contracting parties). The essence of a contract is that it consists of an exchange of promises ("something for something") that is legally enforceable. The "something" can be money, services, property, rights... almost anything.

A 'contract' describes an agreement that meets the legal requirements to be enforced as binding on the parties by a court of law – offer, acceptance, consideration and intention (discussed in more detail below).

While 'agreement' is often used as a synonym for 'contract', some agreements are unenforceable because they lack an essential element to be a legally binding contract.

Throughout life you will enter into thousands of contracts without even realising it. For example: getting on a bus; buying ticket to attend a concert; subscribing to a pay TV service; or downloading music from iTunes, are activities that involve entering into a contract. The terms and conditions of the use of the service may simply be referred to on the back of the ticket, or may be a written agreement you are expected to sign, or you 'clickthru' a button on a website that has the legal effect that you are accepting terms and conditions - whether you choose to read or choose to ignore the terms and conditions

See the Arts Law information sheet Contracts: a glossary of jargon.

More about contracts

Elements of contracts

A contract requires 4 elements:

- **Offer**: a clear offer by one person or organisation to another. If an offer is rejected, that offer automatically ends;
- **Acceptance**: the other party must accept the offer in a way that results in a 'meeting of minds' (i.e. there is consensus as to the terms of the offer and acceptance). A counteroffer is not

acceptance. For example, if an art buyer offers you $500 for your painting and you say that you would take $600, you have not accepted the buyer's offer, but made a new offer that the buyer can accept or reject. There can be many offers and counter offers before there is consensus.

- **Consideration**: the exchange of something of value (known as 'consideration'). This is what each party gives to the other as the agreed price for the other's promises or payment. Consideration doesn't have to be money, it can be any commitment to do something that is a benefit to the party receiving that promise; and
- **Intention**: the people or organisations entering into the contract must intend to create legal relations.

What is not a contract: 'agreements to agree'

In addition to the elements of a contract that are described above, there must be certainty about the important terms as to the subject matter of what the parties are agreeing to do or refrain from doing. There will be differences as to what are the important terms between different transactions. Possible key terms are: what are the specific actions or obligations that are promised; who must perform what is promised; when is the performance of the promises is to be carried out; how is the quality of performance o be assessed; and how is payment to be calculated. If there is uncertainty about the subject matter of what the parties are agreeing to do, the risk is that the contract is 'void for uncertainty'. That is, what the parties intended to be a legally binding commitment will not be enforced by a court. For example, an actor was promised that in consideration of entering the acting agreement, the actor would be paid a 'reasonable' share of profits if the film was successful. This agreement is 'void for uncertainty' as a consequence of the failure to agree a specific percentage share of profits.

Negotiations sometime end up with a meeting of the minds of the parties about most actions or obligations; however the parties are unable to reach agreement about some other matter. It is a common practice to document this agreement by stating that the "parties agree to negotiate in good faith about …" as the parties intend to revisit this matter sometime in the future. The problem with this approach is that courts may well consider this to be 'void for uncertainty'. Where the parties are unable to reach agreement about some matter, the better approach is to establish some workable default formula or objective standard or mechanism (such as binding arbitration proceedings) by which certainty as to the matter is to be achieved. For example, if a script writer is intending to work on a production where there are several writers, but the parties are unable to agreement the fees for the writer because the budget is not confirmed, the contract might state that the writer's fee to be agreed cannot be less than the highest fee paid to any other writer engaged to work on the production.

The failure to provide for any form of consideration in an agreement may be the result of the promises flowing one way between the parties rather than there being a mutual exchange of promises between the parties. If there is doubt as to whether the requirement of consideration has been met, then there are two ways to address that problem: (1) provide for nominal consideration; or set out the agreement in the form of a deed. Contract law, unlike tax law, does expect the value of the consideration to be the market value or any other objective assessment of value. Nominal consideration can be anything that may be considered to have some value. A common form in which nominal consideration is expressed is "the payment of $1 (receipt of which is acknowledged)".

What is a 'deed'?

A deed is a special type of agreement that is recognised by courts as being a binding legal obligation, even if the parties have not exchanged something of value (consideration). In other words, a one-way promise can be an enforceable contract if it is drafted in the form of a deed. Special formal requirements

must be met when writing and executing (signing) a deed and if the requirements are not complied with the deed may not be valid and enforceable.

The description of the parties (at the start of the document) and the statements that describe the purpose of the document (the 'Recitals') and the operative part of the document should use the language of a deed (i.e. using the formal language, such as 'This deed witnesses", that is characteristic of a deed). A deed also needs to: (i) state at the end that it is "executed as a deed" above where the document is signed and witnessed; (ii) be inscribed with the words "signed, sealed and delivered" where each signature of each party will be placed; (iii) have the signatures witnessed by a person who is not a party to the deed; and (iv) have the executed copies exchanged between the parties (which is the 'delivery' of the deed).

Section 127 of the *Corporations Law 2001 (Cth)* describes how companies can execute deeds. The use of a Common Seal is no longer a requirement. Under s. 127 the document must state that it is 'executed as a deed' and that it is signed by 2 directors; or a director and the company secretary'; or for a company that has a sole director – that director will sign. At Common Law a deed is not required to be witnessed, however as the legislation of many states and territories require deeds to be witnessed in relation to specific transactions – therefore it is a safe practice when using the deed form, to have a witness for each signature; with the name and address of the witness being printed below their signature. As a deed binds the signatory at the time of signing and deliver to the other party or parties you should consider whether there should be a meeting where all the parties sign the deed; or include in the deed a condition that states the deed will not take effect until all parties have executed the deed.

The intention to enter into a contractual relationship and legal capacity

Parties do not have the intention to enter into a contractual relationship if the negotiations are being conducted under the explicit understanding that the negotiations are 'subject to contract' or 'subject to a written contract being signed by the parties'.

Not all people are free to enter into a contract – obtaining a valid contract can problematic in relation to the following:

- bankrupts;
- young people under the age of 18 years (minors); and
- people who have a mental impairment (which includes a person who is incapable of understanding what he or she is doing, by reason of intoxication by drug or alcohol).

Bankrupt people retain their general capacity to contract although the *Bankruptcy Act 1966* (Cth) may require the bankruptcy to be disclosed when obtaining obtaining credit.

In relation to children under 18, it is prudent to ask their legal guardian to sign on the child's behalf. The parents of children under 18 are their legal guardians; in many situations parents are asked sign contracts on behalf of children so that the agreement is with the parent or guardian who has the legal capacity to enter into the agreement. The effect of state or territory law may allow a young person to apply to a court when they come of age for an order that any contract they made as a minor is unenforceable.

Where a person, as a result of mental impairment, is unable to understand the nature of the contract being made - that contract may be 'voidable' by order of a court - provided that the other party knew, or ought to have known, of that person's mental impairment. Contracting with a person with a serious long term mental impairment will usually necessitate contracting with the guardian or administrator acting on behalf of that person. When dealing with person who is incapable of understanding what he or she is

doing, by reason of intoxication by drugs or alcohol – the solution is to wait until they are capable of rational decision making before seeking their consent to any agreement.

In relation to corporate entities, the constitution on the corporate entity may limit what transactions the entity can enter into or the authority of a person to sign an agreement on behalf of the corporate entity may be challenged. The best practice is to carry out a 'due diligence' on the capacity of the corporate entity to enter into contracts and the authority of the person who is to sign an agreement on behalf of the corporate entity.

How do you make a contract?

Sometimes contracts need to be written. In general, though, a contract can be:

- oral;
- in writing;
- partly oral and partly in writing; or
- made by people's actions.

This means that a contract may be made up of a number of different documents, emails and conversations.

The *Electronic Transactions Act 1999* (**ETA**) confirms that for the purposes of a law of the Commonwealth, a transaction can take place by means of one or more electronic communications, such as emails, or through internet ecommerce systems. The ETA (as well as state and territory electronic transaction statutes) describes how a requirement to give information in writing and to provide a signature can be met in electronic form; and also sets out rules for determining the time and place of the dispatch and receipt of an electronic communication.

Written contracts do not need to be the formal kind a lawyer would draft. While they can be based on a sample contract such as those available for purchase from Arts Law, generally you don't need to follow a particular form. It is always best, though, if a written agreement is in plain language so that all parties understand it.

If there is uncertainty as to the meaning of the language used – if the meaning is not clear and easy to understand, then arguments may result. If the parties to the agreement cannot negotiate a successful outcome to their dispute as to the meaning of their agreement, then the relationship may collapse and the parties may need to consult lawyers to attempt to settle the dispute or engage in legal proceedings to have a judge determine the meaning of the language used in the written agreement. Arts Law provides a mediation service that can be used as less expensive dispute resolution procedure that involves a trained mediator assisting the parties to resolve their dispute.

The dangers of using documents found on the internet

While the internet can be a source of sample agreements, however care must be taken with regard to contracts that originate in other countries as a sample agreement found on the internet may have been written to comply with the law of another country, so that the sample agreement may not be consistent with the law of Australia.

For example, in the United States agreements dealing with the creation of a copyright work may use the expression that it is a "work made for hire", however that expression does not appear in the Australian

Copyright Act. If a sample agreement from a U.S. website is used in relation to the creation of a copyright work in Australia, there can be uncertainty as to who owns the copyright in the work if the document uses the expression that it is a "work made for hire". When dealing with a copyright work created by an employee or an independent contractor or when commissioning the creation of a work, the relevant provisions of the agreement should be drafted to conform to the requirements of the Copyright Act 1968 (Cth) as to who is the first owner of copyright in a work and how the Copyright Act provides for the transfer of ownership in copyright by way of an assignment or the granting of permission to use a copyright work in the form of a licence of copyright. Therefore care must be taken with a sample agreement found on the internet and all necessary changes must be made to the sample agreement so that it is consistent with Australian contract and copyright law.

Basic contract tips:

Steps that should be done or things that should be considered when entering into a contract include:

Do your research

The piece of paper you sign may be worthless if you are dealing with someone who is bankrupt or untrustworthy. Who is the other party? Are they a company or an individual? Who are you really entering into the contract with?

The Australian Securities and Investment Commission (ASIC) is the government organisation which registers all companies and also registers business names (whether the business name is used by a company, an individual or some other trading entity).

Steps you can take include searching the ASIC's website to check if the business name or company is registered and check the public register of people who have been banned or disqualified from running companies. You can also pay for reports on information about companies, such as the names of the directors, either directly from the AISC or using an ASIC approved information broker.

Call your local consumer affairs body to see if they have had any adverse reports. Ask around!

Information about Indigenous corporations set up under the Corporations (Aboriginal and Torres Strait Islander) Act 2006 (Cth) can be found that the Registrar of Indigenous Corporations' website.

Check out whether the person has the authority to make the contract with you

Con artists have sold the Sydney Harbour Bridge to gullible people, so that if the deal is too good to be true – it may not be. Even with transactions that seem to be genuine you may need to check and confirm that the person you are dealing with has the legal authority to enter into the transaction or, when the transaction involves property or rights (such as copyright), whether the person or legal entity you are dealing with actually owns or controls the property or rights so that they have the legal authority to deal in the property or rights.

How extensive any due diligence investigations out carry out will depend on how well know and reputable is the person or organisation; while you may wish to trust in the good faith of the people you are dealing with it is appropriate to ask to see documents and be supplied with information so that you can verify that the person or legal entity you are dealing with actually owns or controls the property or rights so that they have the legal authority to deal in the property or rights.

It may be acceptable to receive the any verification documents with the confidential business and financial terms blanked out. Such as the '**chain of title**' documents that establish ownership of copyright.

It is possible to include **warranties** in the contract as to ownership and other matters that may be important; and also to provide for **indemnities** in relation to the **breach** of those warranties. See the Arts Law information sheet Contracts: a glossary of jargon. However the protection provided by warranties and indemnities may be illusionary if the party that is in breach of the warranties it has given does not have the financial capacity to meet its commitments.

Consider the deal

Make sure that the deal meets your requirements and covers all your concerns.

Also consider the terms that you are being offered. Are they consistent with any industry standard?

The law generally doesn't care if you make a rotten deal for yourself. Whether or not the contract is good or bad for your business, if you have entered into it, you will probably have to perform it.

Negotiate

Sometimes you will be handed a formal-looking contract and told: "This is our standard contract - take it or leave it". You may feel that you have no bargaining power to negotiate better terms for yourself.

There is generally no legal reason why a contract cannot be negotiated. Ensure you read the contract carefully, check anything you are unsure of, make suggestions if you wish to make changes. Sometimes you will be able to convince the other person to let you strike out or add a clause or a sentence. If they won't agree to do that, you should carefully consider whether this deal is good for you. If it isn't, then maybe you should walk away.

Get legal advice

Often you will be told that you must sign a contract within a very short time - even in front of the other party. Don't give in to this kind of pressure. It is only reasonable that you be given sufficient time to get independent legal advice so that you know exactly what you are agreeing to before you sign. It is much harder to retreat from a bad agreement once you have entered into it. You may find yourself with obligations you didn't fully understand or didn't even know about.

Don't give away more than you need to

When you are dealing with your artistic assets, such as copyright, you should make sure you keep control of them. For example, do you really need to assign all of your copyright in a work? Would a licence permitting someone else to use your work be more appropriate? You can limit licences (permissions) by narrowly defining terms such as territory, duration and type of use.

Only promise what you can deliver

You cannot give something that you do not have. Be sure that you can deliver what you say you can.

For example, if you created artwork as an employee (and your employer is actually the copyright owner rather than you) you cannot licence or sell (assign) that copyright.

Put everything in your contract

If you have a written contract, the law generally presumes that it is the whole agreement - so make sure that it is. Don't leave out things as a goodwill gesture or because you assume that they will happen anyway.

Think about the contract practically and consider what will happen under the contract if the relationship sours. Is the duration of the contract too long? Will you be paid in regular instalments or will you have to wait for a lump sum? Can you end the relationship easily?

Get it in writing

Very few contracts are required to be in writing. Exceptions include contracts containing an assignment or an exclusive licence of copyright. If, however, there is a dispute about an oral contract, it may come down to your word against the other party's. Many disputes can be avoided if the agreement is in, or is confirmed by, writing.

If someone is hesitant about putting things in writing, you should ask yourself why. Are they perhaps thinking of sliding out of the contract later? Or is it simply not their "way"? You can explain to them that having a written contract is not a sign of distrust. Rather, the purpose of a written contract is to have a clear, unambiguous document that clarifies both parties' rights and obligations and, if they wish, sets out a procedure if something goes wrong.

If the other person still resists putting things in writing, you should keep your own notes of the oral contract and then write a follow-up letter in simple, non-threatening language confirming the arrangements.

Ask the other person to check the letter over and sign it if they agree with it. If they sign it, you have proof of the contract in writing. If they dispute it, you will have flushed out the misunderstandings. You can then amend the letter until you are both happy to sign it. Even if they ignore it, you **may** still be able to argue that they agreed to it by their conduct.

The bottom line is that any written evidence of the contract, even if it is just an invoice with terms noted, will help determine what was agreed.

Keep a copy of all documents you sign and read them often!

Signing a contract is evidence that you agree to its terms. You will usually be bound to perform the contract as it is written. It is a good idea to get two identical originals of a contract signed by both parties. Each party then keeps one signed original. At the very least, make sure that you get a *copy* of the original signed agreement when it has been fully signed. The other party isn't obliged to give you a copy of the signed contract later on!

Need more help?

Contact Arts Law (http://www.artslaw.com.au/), tel. (02) 9356 2566 or toll-free outside Sydney: 1800 221 457

Disclaimer

The information in this information sheet is general. It does not constitute, and should be not relied on as, legal advice. The Arts Law Centre of Australia (**Arts Law**) recommends seeking advice from a qualified lawyer on the legal issues affecting you before acting on any legal matter.

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