

Understanding contracts

Legal information for community organisations

This fact sheet covers:

- general principles of contract law
- reviewing a contract
- specific types of contracts, and
- approval processes for contracts.

Contracts are part of everyday operations for many not-for-profits. It's important to know what issues to look out for when signing on the dotted line.

Although your organisation may not have much power to negotiate when signing contracts, especially standard form contracts, there are some key principles to consider. If a contract is too risky, your organisation can always choose not to sign.

1. General principles

What is a contract?

A contract is a legally-binding promise or agreement made between two or more 'parties'. A contract may be oral or written. A contract will be valid and enforceable only if it meets the four formal requirements for a contract:

- 1. agreement (an offer is made, and that offer accepted)**
- 2. consideration (an exchange or benefit – each party gives something in return)**
- 3. intention to create legal relations (it is clear that the parties intended the agreement to be binding – distinct from early negotiations or discussions that are not binding), and**
- 4. certainty of terms (the subject matter, key promises about the subject matter, timing and parties are all clear and certain).**

If an agreement meets the four requirements, it will be legally binding on the parties involved. This means that there can be consequences if the parties don't do what they have said they will do under the contract

Who can a contract be enforced against?

A contract can only be enforced against those who are a party to the contract. This concept, known as privity, prevents individuals or businesses who are not parties to a contract from being able to enforce



TIP

Although most contracts do not need to be in writing, oral contracts can be difficult to prove and enforce. For this reason, all contracts should be in writing, and signed, where possible.

the obligations of the contract, or have the obligations enforced against them. Privity can become an important issue in contracts made by two parties but intended to benefit a third party. In general, at least one of the contracting parties will have to be willing to enforce the contract if the third party is not receiving the intended benefit.

It is important to be clear who you are contracting with. Is it an individual or a business? If it is a business, is the business registered in Australia or overseas? Some groups of people, including businesses and associations cannot enter into agreements in their own right. Additionally, business names are not always the same as companies or the individual that owns the business name. These issues are important when determining the risks of entering into a contract, and determining who to enforce the contract against in the case of a dispute.

What are the consequences of breaching a contract?

This area of law can be complex, however in general, if one party breaches its obligations to another party under a contract, then a court can require the breaching party to compensate the other party/s for the losses they suffer because of the breach. This compensation is referred to as 'damages'. Often, a Court will award damages rather than make a party do what they said they would under the contract (which is known as 'specific performance'). So, although a contract is binding, one party may not be able to force the other party to do what they agreed to, but damages may be available.

EXAMPLE

Kids of Brunswick is a charity holding a fundraising event in a local restaurant. On the day of the event the restaurant says that they have had a last minute request to hold a wedding, and that the wedding party was willing to pay double the price being paid by the charity, and therefore they were cancelling the booking.

Kids of Brunswick's committee urgently meet. They find that they have a series of emails with the restaurant including the terms of hire, a confirmation of booking, and record of the deposit paid. In their view, this series of emails amounts to a contract.

They call back the restaurant and tell them that they are breaching their contract to hire out the restaurant. The restaurant tells them they are sorry, but they will not perform their obligations under the contract. This refusal is a breach of the contract.

Kids of Brunswick ends up finding a hall to hire at the last minute, and is able to organise for a number of caterers to come along and provide the food and service for guests. Kids of Brunswick did their best to get a reasonable price, but because of their last minute request, the caterers and hall hire end up costing four times the price they would have paid for the restaurant.

Kids of Brunswick speaks to a lawyer after the event, who advises them they can seek damages from the local restaurant – the difference in the price they would have paid, and the more expensive price they had to pay because of the restaurant's breach. The lawyer writes a letter to the restaurant, and after speaking to their own lawyers, they eventually agree to pay the difference.

TIP: It's important to mitigate loss when a party has breached an agreement. Just because a party has breached a contract is not a licence to accumulate huge losses and expect these to be covered. Only a reasonable amount can be recovered.

What about non-binding agreements?

Some documents look like contracts, but are not intended to be binding. For example, in some cases the parties will create a non-binding Memorandum of Understanding (**MOU**) to set out the framework of a proposed arrangement to aid further discussion and negotiation. If a document such as an MOU is not intended to be binding, this should be clearly stated in the document.

There can also be 'agreements to agree', which like an MOU set out parties' intentions, but do not create binding obligations.

CAUTION

If your organisation is signing a document, but does not intend it to be binding, it is very important to make sure that the document reflects this. The document should clearly state that it does not intend to create binding obligations.

Similarly, if your organisation is relying on statements in a document that say it is not intended to be binding, this could cause problems – you may wish to enter into a contract rather than a non-binding agreement.



What are deeds?

A deed is a special type of contract. A deed does not require consideration (see 'What is a contract?') to be valid and enforceable, and so deeds are sometimes used where there is no consideration, or it may be open to question. An example is when property is given as a gift. There is no consideration, so a deed of transfer of ownership is often used.

Execution (signing) and enforcement

To avoid difficulties enforcing a contract, check that it will be signed by authorised persons. The organisation's constitution may contain special rules about how the organisation can execute documents. It is common practice for:

- corporations to execute by two directors, or one director and the secretary, and
- incorporated associations to execute by two members of the committee, or one member of the committee and the secretary.

TIP

For very important contracts, some parties may even ask for evidence that the person signing has authority to do so, such as by requiring identification and evidence that a relevant position is held.

ELECTRONIC SIGNATURES

A contract will not be considered invalid simply because it was executed with an electronic or digital signature. This often involves inserting a picture of the person's signature into a document, but there are also third-party applications that allow for a person to sign using special software, or by drawing their signature on a smartphone or tablet. This area is rapidly evolving, so you may need to seek advice about the appropriateness of a particular electronic signature technique.

Often, such a signature will be treated just the same as an ink signature on paper provided that the key elements of a contract are present (offer and acceptance, consideration, the intention to create legal binding relations, and certainty of terms of the agreement, as discussed above). Sometimes, especially when contracting with Government, special rules apply about what documents can be signed electronically. Organisations should ensure that they have appropriate procedures and policies around providing electronic signatures. Only those with the appropriate decision making (or delegated decision making) authority, in accordance with your organisation's policies and procedures should be able to sign electronically, or provide



explicit permission for someone to sign on their behalf. It is important to understand that an electronic signature can be challenged just like a written signature (ie. a person may deny that they signed) and therefore, if you are arranging for the execution of an important contract, it can be valuable to require extra steps, such as that the signing is witnessed.

For more information on electronic signatures see the information sheet provided by Hewlett Packard Enterprise's in-house legal team at www.ncoss.org.au/news-and-events/community-sector-news/electronic-signatures-are-they-safe.

Varying a contract

Contract terms can be amended or changed (known as 'variation') after the contract has come into force. This is done by agreement between all the parties to the contract. Some contracts will specifically deal with the requirements of a valid variation, and may limit what can be varied. All variations should be in writing and signed by each party to the contract.

Executing a deed of amendment or variation is often the best option, particularly where there is no consideration involved in the variation (beyond the consideration already provided for under the original contract).

Ending a contract

A contract can come to an end in a range of ways:

- **Performance** – when the parties have finished fulfilling their obligations under the contract
- **Agreement** – this can involve parties mutually agreeing to release each other from their obligations under the contract (mutual discharge) or replacing the contract with a new contract (novation).
- **Operation of law** – a contract may automatically terminate by operation of law. This can include, for example, where one party to a contract dies.
- **Frustration** – where the performance of a contract becomes impossible through no fault of either party to the contract. The contract is automatically terminated at the point of frustration. It is important to note that only future obligations are discharged at the point of frustration. Obligations which fell due for performance before the frustrating event are still enforceable.
- **Breach** – termination of a contract for breach of contract can result from either actual or anticipated breach. Generally, termination is only available where there has been a breach of an essential term of a contract, or a sufficiently serious breach of a non-essential term of a contract.

! CAUTION

When seeking to terminate due to a breach by the other party, it is important to determine the seriousness of the breach. Only serious or fundamental breaches result in an innocent party having the right to terminate. Purporting to terminate when you have no right to do so can have serious consequences including liability to pay the other party damages.

2. Reviewing a contract

Make sure that you read the entire contract. The most important two questions are:

- does each party understand the promises made to them, and the promises made by them, under the contract? and
- is each party able to deliver on their promises?

You should read and understand the entire contract, and if it is an important contract you should get legal advice. However some specific issues to consider are outlined below to help guide a contract review.

Term (duration)

Is the contract a 'one-off' arrangement (eg. purchase of office equipment), or is it for a defined period of time (eg. one year of office equipment maintenance/servicing)? Some contracts 'renew' automatically unless a party cancels. If the contract is an 'ongoing' or 'automatically extending' contract, make sure that your organisation understands how the cancellation process works and how much notice is required – and then put these dates in your diaries!

Similarly, some contracts have an option to renew that needs to be exercised by providing notice of a wish to renew within a certain timeframe. These dates should also be diarised.

Termination

Does the contract permit early termination? Be particularly alert to 'one-sided' termination clauses in standard form contracts, which allow the other party but not your organisation to terminate. If there is a chance that your organisation might want to end the contract early, then consider asking for an early termination right. For example, if your organisation loses funding for a project then it might be necessary to end contracts with service providers for that project.

Termination rights can be 'for convenience' (for any reason), or can be limited to specific circumstances (eg. your organisation losing funding). If a contract is terminated early but that termination is not permitted by the contract, then the terminating party will breach the contract – see 'What are the consequences of breaching a contract?' above.

Obligations to pay money

Scoping

Is a payment required only once, or are recurring/ongoing payments required? Consider timing: are payments required in advance, or after receiving a product/service? Are any prices clearly specified in the contract, and do they include GST? Do prices change over the term of the contract (e.g. annually, or upon renewal of the term)?

Capacity

- if your organisation is required to make payments to the other party, does your organisation have sufficient funding? Will your organisation have the funds at the times that payments are due under the contract?
- if the other party is required to make payments to your organisation, are you confident that the other party has sufficient funding? Would it be sensible to ask for part or all of the money up front?

Obligations to provide goods or services

Scoping

What are the goods or services that are to be provided under the contract? Make sure that both parties understand exactly what is to be provided or done. If appropriate, consider attaching photos, diagrams, plans, samples, colour swatches or detailed requirements, such as 'service standards' to the contract as a 'schedule'.

Capacity

- if your organisation is required to provide goods or services, then does your organisation have the resources to do so (eg. staff, equipment)? Can your organisation provide the goods or services to the specifications required, and in the timeframes required? Will your organisation have (or receive) the funds necessary to provide the goods or services?
- if the other party is required to provide goods or services, are you confident that the other party has the resources and expertise to deliver?

Liabilities and indemnities

An indemnity is essentially a promise to compensate another party for loss or damage that they suffer either directly or indirectly as a result of the contract. An indemnity can be broad. It can apply if your organisation has only a very small involvement, or no involvement, in the loss or damage. Indemnities can expose your organisation to very significant liabilities. Read an indemnity clause carefully. Think about 'what could go wrong' – that is, what loss or damage could be suffered by the party your organisation is indemnifying. Consider whether that financial exposure is acceptable. Consider whether your organisation has any relevant insurance, or whether any should be taken out.

Time for performance

Does the contract stipulate a time for performance of the obligations under the contract? If timing is an essential term of the contract, it is important to follow the requirements within the required time frame or significant damages may result.

Dispute Resolution

It is important to review any dispute resolution clause to determine how disputes are to be dealt with under the contract. A contract may require a party to follow a certain procedure for resolving disputes. Failure to follow these procedures carefully can result in otherwise valid claims under the contract becoming invalidated or excluded. A contract may also require a party to seek alternative dispute resolution (ADR) such as mediation or arbitration before commencing legal proceedings.

Purposes of your organisation

Keep in mind that not-for-profit organisations must ensure that they act within the scope of the purposes of the organisation. If you are not sure what the exact purposes of your organisation are, you may find a statement of purposes in the constitution or the rules of your organisation. Ask yourself whether the contract is consistent and within the scope of those purposes.

Deductible Gift Recipient (DGR) status

If your organisation has DGR status, then consider whether the proposed contract is consistent with the 'dominant purpose' or 'principal purpose' that your organisation is required to pursue in order to maintain that status.

Branding and intellectual property

Does the agreement allow another party to use your organisation's brand, or other intellectual property such as your organisation's work product or know how? Consider what limitations should be placed on this. If intellectual property is created in connection with the agreement, then which party has the rights to that intellectual property?

FURTHER READING

For further information on intellectual property read Not-for-profit Law's Guide to Intellectual Property at www.nfplaw.org.au/ip. The guide assists community organisations to understand the basics of making and protecting intellectual property, and avoiding infringing the intellectual property of others.



3. Special types of contracts

The following comments relate to specific types of contracts that your organisation may come across.

Funding agreements

There is often limited scope to negotiate funding agreements, but this is not always the case. Sometimes coalitions of like organisations will negotiate together, often through a peak body, for better funding terms. This is especially the case where there is a common funding agreement in place.

If your organisation is not able to negotiate funding terms, you will need to decide whether to proceed (with an understanding of the risks) or walk away from the opportunity. Pay close attention to the following:

- can the government or other funder terminate or suspend the contract, or change the terms, without your organisation's consent? Consider carefully what could happen if those rights are exercised. Are you able to build related rights into any other contracts that your organisation enters into with suppliers?
- is your organisation set up to meet all the detailed record-keeping, audit and insurance requirements?
- is your organisation required to grant intellectual property rights to the government (including in relation to 'background' or pre-existing intellectual property)?

Consumer contracts

Under the Australian Consumer Law (**ACL**), goods or services purchased by 'consumers' come with automatic guarantees, including that they will work and do what you asked for. For the purposes of the ACL, a person, including a business, is taken to have acquired goods or services as a consumer if:

- they are purchased (or hired or leased) for under \$40,000; or
- they are purchased (or hired or leased) for over \$40,000 and are normally bought for personal or household use

If the goods or services do not satisfy the automatic guarantees, consumers may have rights which include a repair, replacement or refund; the ability to cancel a service; or the right to compensation for loss suffered.

Small business contracts

The ACL also includes protections for small businesses (businesses with less than 20 employees) from unfair terms in standard form contracts. A standard form contract is one that is prepared by one party with no opportunity for the other party to negotiate it – that is, contracts offered on a ‘take it or leave it’ basis. These protections apply to contracts entered into on or renewed after 12 November 2016. If a contract is varied on or after 12 November 2016, the law applies to the varied terms.

Ultimately, whether a term in a standard term contract is unfair is a consideration for a court or tribunal, The ACL sets out examples of unfair terms which include terms that enable one party (but not another) to avoid or limit their obligations or to vary or terminate a contract. Terms which penalise one party (but not another) may also be unfair.

FURTHER READING

For more information about unfair contract terms and consumer guarantees read Not-for-profit Law’s Contracts overview page on the Information Hub at www.nfplaw.org.au/contractsoverview.

FURTHER READING

For more information consumer guarantees, visit the Australian Competition and Consumer Commission’s page [Consumer Guarantees](#); and for more information on unfair terms in standard form contracts, visit the Australian Competition and Consumer Commission’s page [Unfair Contract Terms](#).



Auspicing agreements

Auspicing agreements can be particularly risky for ‘host’ organisations. See in particular ‘Purposes of your organisation’ and ‘Deductible Gift Recipient (DGR) status’ above. If you are proposing to auspice a project that your organisation would not normally consider doing itself, this is a ‘red flag’ to look at the circumstances very carefully and ensure that they are consistent with your organisation’s purposes, and any conditions or restrictions due to tax concessions. Also remember that your organisation (and not the party that you are auspicing) will be responsible to the funding organisation.

RELATED RESOURCES

For more information of auspicing, go to our Auspicing page on the Information Hub at www.nfplaw.org.au/auspicing



Leases

In addition to making sure that your organisation is happy with the key commercial terms, some of the less obvious liabilities that should be considered before entering into a lease include:

- **outgoings:** make sure that you understand all outgoings which may include general utilities as well as charges for cleaning, security or landscape services (depending on the premises)
- **repair and make good clauses:** some landlords require the tenant to regularly maintain the premises (such as painting or recarpeting every 5 years), so ensure that your organisation budgets for this. Also take note of the end of lease requirements concerning the state in which your organisation must leave the premises
- **rent review:** have a clear understanding of the rent review process set out in the lease so that you can budget for rent increases during the term

- **options to renew:** if there is an option to renew and your organisation wishes to exercise it so that your organisation can stay longer than the initial term, ensure compliance with the notice periods set out in the lease
- **insurance requirements:** in some cases tenants are required to take out insurances which add to the overall cost of the premises, and
- **permitted use and zoning:** ensure the permitted use stated in the lease is approved under the relevant zoning.

RELATED RESOURCES

Not-for-profit Law has a detailed resource on lease agreements for Victorian organisations at www.nfplaw.org.au/leases



4. Approval processes

Approval processes for contracts vary by organisation. At some organisations, for example, all contracts, or contracts that fall into certain categories, must be approved by the board. Find out what approval processes apply when you start to negotiate a contract, so that you can arrange those approvals in time and avoid delays towards the end of the process.

Resources

Related Not-for-profit Law Resources

The Not-for-profit Law Information Hub (www.nfplaw.org.au) has resources on the following related topics:

▀ Risk and insurance – www.nfplaw.org.au/riskinsurance

This section of the Information Hub features resources on insurance, conducting background checks, negligence, work health and safety, Personal Property Securities Register and criminal conduct.

▀ Leases (for Victorian organisations) – www.nfplaw.org.au/leases

This page provides information on the legal issues to look out for when leasing property.

▀ Who runs the organisation – www.nfplaw.org.au/whoruns

This section offers information on the role of board members and positions in companies limited by guarantee, and incorporated associations.

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