

# Understanding contracts



## Legal information for community organisations

### This fact sheet covers:

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



### Disclaimer

This fact sheet provides general information about contracts. This information is a guide only and is not legal advice. If you or your organisation has a specific legal issue, you should seek legal advice before deciding what to do.

Please refer to [the full disclaimer](#) that applies to this fact sheet.

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

Although your organisation may not have much bargaining power when negotiating and signing contracts, especially standard form contracts, there are some key principles to consider.



### Tip

If a contract is too risky, you should seek legal advice. Your organisation can always choose not to sign it.

## 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 the following **four formal requirements** are met:

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

If an agreement meets these four requirements, it will be **legally binding** on the parties to the contract and the parties will have rights and obligations under the contract. This means there can be consequences if the parties don't do what they have said they will do (that is, perform the promises each party has made) 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 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.



### Note – who are you contracting with?

Be clear about who you are contracting with – for example, an individual or company?

If it's a company, is the business registered in Australia or overseas? Have you checked the company has an ACN, and this is described accurately in the contract? Some groups of people, including businesses and associations, can't enter into agreements in their own right. Additionally, business names are not always the same as companies or the person that owns the business name.

If you are contracting with an individual, are they who they say they are? Check the individual's identity documents to ensure the person you are dealing with is who they say they are.

Knowing who you are contracting with is important when determining:

- the risks of entering into a contract, and
- who to enforce the contract against in 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 (or parties) under a contract, then a court can require the breaching party to compensate the other party (or parties) for any losses suffered 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 and requires performance, one party may not be able to force the other party (or parties) 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 cancels the booking, saying they have had a last minute request to hold a wedding, and that the wedding party is willing to pay double the price being paid by the charity.

Kids of Brunswick's committee meet urgently. They locate a series of emails with the restaurant that include 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 the restaurant and tell them 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 finds a hall to hire at the last minute and is able to organise a number of caterers to provide food and service for the 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 for breach of contract – 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, the restaurant eventually agrees 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's very important to make sure that the document clearly states 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 may cause problems if your organisation acts inconsistently with what the document says – so be careful and consider whether it would be more appropriate for your organisation to enter into a contract rather than rely on a non-document.



### What is a deed?

A deed is a special type of binding promise or commitment to do something.

A deed does **not** require consideration (see 'What is a contract?' above) to be valid and enforceable, so deeds are sometimes used where there is no consideration, or it may be open to question. Different states and territories may have specific formality requirements for deeds to be valid.

The lack of consideration is overcome by the idea that the deed is intended by the executing party to be a solemn indication that the person signing the deed really means to uphold their promise. 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's 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

Ask for evidence that the person signing has authority to do so, such as by requiring identification and evidence that a relevant position in the company or organisation is held.



### Note – electronic signatures

A contract may be executed with an electronic or digital signature in certain circumstances.

Signing a document electronically or digitally often involves inserting a picture of the person's signature into a document, but there are also third-party applications (such as DocuSign) that allow for a person to sign using special software, or by drawing their signature on a smartphone or tablet.

In many cases, an electronic signature will be treated 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 legally binding relations, and certainty of terms of the agreement, as discussed above).

Different rules may apply to deeds depending on which state or territory law governs the deed. If unsure, or if you are contracting with an overseas business, you should seek advice about the appropriateness of a particular electronic signature technique.

Sometimes, especially when contracting with Government, special rules apply about what documents can be signed electronically. **Take care to check whether any special rules apply.**

Organisations should ensure 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 and applicable legal requirements should be able to sign electronically, or provide explicit permission for someone to sign on their behalf. **If signing documents with another organisation, check to confirm the organisation and the person signing is authorised to sign electronically.**

An electronic signature can be challenged just like a written signature (for example, a person may deny that they signed), so, if you're arranging execution of an contract, it can be worthwhile requiring extra steps, such as that the signing is witnessed.

## 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, and the parties must adhere to the requirements of a valid variation.

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). Sometimes variations may be done by a 'side letter'.

## Ending a contract

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

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| • <b>Performance</b> | This is when the parties have finished fulfilling their obligations under the contract.   |
| • <b>Agreement</b>   | 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). |



• <b>Operation of law</b>	A contract may automatically terminate by operation of law. This can include, for example, where one party to a contract dies.
• <b>Repudiation</b>	This is when a party shows an intention to no longer be bound by the contract or to fulfil the contract in a manner substantially inconsistent with their obligations. This does not always include situations where a party has a different or incorrect view of its obligations under the contract.
• <b>Frustration</b>	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's 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.
• <b>Breach</b>	The end of a contract for breach can result from either actual or anticipated breach of an essential term of a contract, or a sufficiently serious breach of a non-essential term of a contract.
• <b>Termination</b>	This is where the parties agree that the contract may be determined by a period of notice, or upon occurrence of a specific event.



### Caution

When seeking to terminate (end) a contract due to a breach by the other party, it's 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.

## Reviewing a contract

You should read and understand the entire contract.



### The two most important questions to ask when reviewing a contract:

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

To help guide you through reviewing and understanding an entire contract, we have outlined some specific issues for you to consider below.

<b>Term (duration)</b>	Is the contract a 'one-off' arrangement (for example, the purchase of office equipment), or is it for a defined period (for example, one year of office equipment maintenance or servicing)?  Some contracts 'renew' automatically unless a party cancels – be particularly careful about these in standard form contracts. If the contract is an 'ongoing' or 'automatically extending' contract, make sure your organisation
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	<p>understands how the cancellation process works and how much notice is required – and then put these dates in your diary.</p> <p>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.</p>
<b>Termination</b>	<p>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, 'for convenience' or on the giving of a period of notice). For example, if your organisation loses funding for a project, it might be necessary to end contracts with service providers for that project.</p> <p>Termination rights can be 'for convenience' (for any reason), or can be limited to specific circumstances (for example, if your organisation loses funding).</p> <p>If a contract is terminated early but that termination is not permitted by the contract, then the terminating party will breach the contract.</p>
<b>Obligations to pay money</b>	<p><b>Scoping</b></p> <p>Is a payment required only once, or are recurring (ongoing) payments required? How do these payments need to be made, and by when?</p> <p>Consider timing – are payments required in advance, or after receiving a product or service? Are any prices clearly specified in the contract, and do they include GST? Do prices change over the term of the contract (for example, annually, or on renewal of the term)?</p> <p><b>Capacity</b></p> <ul style="list-style-type: none"> <li>• 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?</li> <li>• if the other party is required to make payments to your organisation, are you confident that the other party has sufficient funding? Have you checked its financial position? Would it be sensible to ask for part or all the money up front?</li> </ul>
<b>Obligations to provide goods or services</b>	<p><b>Scoping</b></p> <p>What are the goods or services that are to be provided under the contract? Make sure 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'.</p> <p><b>Capacity</b></p> <ul style="list-style-type: none"> <li>• if your organisation is required to provide goods or services, is your organisation able to meet the time for supply and does it have the resources to do so (for example, staff and 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?</li> <li>• 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?</li> </ul>
<b>Liabilities and indemnities</b>	<p>An indemnity is essentially a promise by one party to compensate another party for loss or damage that the other party suffers either directly or indirectly as a result of performance (or non-performance) of the contract.</p> <p>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.</p>



	<p>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 to cover a breach of indemnity.</p>
<b>Force Majeure</b>	<p>A force majeure clause relieves a party from performing its contractual obligations due to an event outside the reasonable control of the affected party.</p> <p>Force majeure clauses usually exclude liability for a party who is unable to perform their contractual obligations due to a 'force majeure event', on the basis that such events are outside of the party's control. Examples of 'force majeure events' may include acts of God, natural disasters, national emergencies, government action or interference, wars or pandemics, but the types of events covered will depend on how the clause is drafted. Some clauses may specify an exhaustive list of events covered by the clause, whereas others may be open-ended and just give examples.</p> <p>If you anticipate that certain types of 'force majeure events' would drastically impact your ability to fulfil your obligations under the contract, it may benefit you to include that type of event in the contract's definition of force majeure.</p> <p>Also check that the party impacted by the 'force majeure event' is required to use reasonable endeavours to mitigate the effect of that event on its ability to fulfil the contract</p>
<b>Time for performance</b>	<p>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.</p>
<b>Dispute Resolution</b>	<p>It's important to review any dispute resolution clause to determine how disputes are to be dealt with under the contract.</p> <p>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.</p> <p>A contract may also require a party to seek alternative dispute resolution such as mediation or arbitration before starting formal legal proceedings in a court or tribunal.</p>
<b>Purposes of your organisation</b>	<p>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 rules) of your organisation. Consider whether the contract is consistent and within the scope of those purposes.</p>
<b>Deductible Gift Recipient (DGR) status</b>	<p>If your organisation has DGR status, 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.</p>
<b>Branding and intellectual property</b>	<p>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 the terms of any licence and what limitations should be placed on this.</p> <p>If intellectual property is created in connection with the agreement, which party has the rights to that intellectual property?</p>





### More information

For more information, see our [guide to intellectual property](#). The guide covers the basics of making and protecting intellectual property, and avoiding infringing the intellectual property of others.

## Specific 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 similar organisations (a coalition) will negotiate together, often through a peak body, for better funding terms subject to any competition laws which prevent them from doing so without a special exemption. 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**), certain 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 'consumer' is defined as a person, including a business, who acquires:

- goods or services costing up to \$100,000 (the individual unit cost of the goods or services is counted, not the total cost if multiple goods or services are purchased)
- goods or services costing more than \$100,000 which are normally bought for personal or household purposes (ie. goods worth more than \$100,000 which are purely for business use, such as machinery or farming equipment, are not subject to the consumer guarantees), and
- any vehicle or trailer used to transport goods on public roads (irrespective of cost)

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



### More information

For more information, see [our fact sheet on Consumer Guarantees](#).

## Unfair contracts

The ACL also includes protections for individuals and small businesses (businesses with less than 100 employees or less than \$10 million in revenue) from unfair terms in standard form contracts (**Unfair Contract Terms protections**).

A standard form contract is one that is prepared by one party with no or very little opportunity for the other party to negotiate it – that is, contracts offered on a ‘take it or leave it’ basis.



### Note – changes to the law

Significant changes to the Unfair Contract Terms protections legislation apply from 9 November 2023 (after a 12 month transition period).

This legislation considerably expands the scope of the unfair contract terms regime by:

- prohibiting unfair contract terms such that businesses proposing or seeking to rely on them would be exposed to the risk of serious penalties
- expanding the definition of small business to capture entities that either have up to 100 employees (increased from 20) or up to \$10 million annual turnover
- for contracts to which the ACL applies, removing the upfront contract value threshold such that the Unfair Contract Terms protections will apply to all relevant standard form contracts with consumers and small businesses, and
- for contracts to which the *Australian Securities and Investment Commission Act 2011* (Cth) applies (including contracts related to financial products, such as credit contracts and insurance contracts), increasing the upfront contract value threshold from \$3 million to \$5 million, such that the Unfair Contract Terms protections will apply to relevant contracts below \$5 million

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.



### More information

For more information, see [our fact sheet on unfair contract terms](#).

## Auspice agreements

Auspice agreements can be particularly risky for 'host' organisations. (See '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, it is prudent to look at the circumstances very carefully and ensure 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 auspicings) will be responsible to the funding organisation.



### More information

For more information, see [our webpage on auspicings](#).

## Lease agreements

**In addition to making sure that your organisation is happy with the key commercial terms, other clauses that you should consider 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 five years), so ensure 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 you can budget for rent increases during the term. You should try to negotiate a specific rent review mechanism (for example, specific amount, or percentage)
- **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 insurance which adds to the overall cost of the premises
- **Permitted use and zoning** – ensure the permitted use stated in the lease is approved under the relevant zoning



### More information

For more information, see [our webpage on lease agreements](#).

## 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 or senior management.

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.