

Contract Law (II)

Part 2: The Australian Legal Environment for Business

Unit 5: Week 6 Tutorial

Learning Objectives

At the end of this tutorial, you should be able to:

- Explain and apply the rules as to intention to create legal relations.
- Explain and apply the rules as to consideration.
- Apply the IPAC method to resolve a legal problem.
- Develop critical thinking and collaboration skills through group work and presentations.

Before this tutorial, you should have:

- Attended Unit 5 lecture
- Read the assigned Readings
- Completed the Tutorial Questions
- Read the In-Class Collaboration and Presentations questions

During this tutorial, you will:

- Demonstrate an understanding of the topic in the unit
- Participate in tutorial activities by:
 - Contributing to group discussions
 - Asking questions
 - Listening actively
 - Working collaboratively with other students
- Complete the In-Class Collaboration and Presentations activity

After this tutorial, you should:

- Consider attending one of the scheduled consultations and attempt to resolve any questions that you have as soon as possible.



Readings

Intention to Create Legal Relations

The existence of an agreement is not enough to make a contract. Contract law requires evidence that the parties intended to do more than make an agreement and that they intend for it to be legally binding and enforceable.

Usually, the presence of consideration will provide evidence of this – if the promisor has specified something as the price for the promise this, in most cases, carries with it an intention that the parties be bound.

Intention remains, however, an independent requirement and must be separately demonstrated and there are cases in which consideration has been present, but no contract found to exist because this pre-condition has not been fulfilled. However, difficulties can arise because parties seldom expressly declare their intention in regard to the legal enforceability or otherwise of their agreement.

Legal Presumptions

As a result, it has become necessary for the courts to imply the intention of those parties from the surrounding circumstances of the case. Accordingly, they have developed two very important legal presumptions:

- where the agreement between the parties is of a **commercial nature**, it is presumed that the parties do intend to be bound by this agreement and that, therefore, such agreement is legally enforceable by either party against the other.
- where the agreement between the parties is of a **social or domestic nature**, it is presumed that the parties do not intend to be legally bound by what they agreed on and that, therefore, such agreement is legally unenforceable.

Being presumptions only, they can be rebutted by evidence to the contrary. Rebuttal requires clear objective evidence of an intention, that the parties did or did not intend legal enforceability.

Commercial and Business Agreements

Where an agreement arises out of a commercial context, there is a rebuttable presumption that the parties intended to be legally bound. This means that the parties will be presumed to have intended to be legally bound unless evidence is presented to show that they did not intend to be bound. The reason for this is that if this presumption did not apply, there would be no certainty that commercial transactions would be honoured and commerce would be less efficient.

The commercial presumption may be rebutted by the circumstances of the case, and when there is proof that one of the parties to the agreement expressly excluded legal relation. Where the parties to a commercial agreement do not intend it to be binding they may indicate that the agreement is not legally binding.

Social and Domestic Agreements

There is a presumption that social and domestic agreements are not intended to create legal relations. In most social and domestic agreements the parties do not usually intend to create legal relations – at least when the agreement is entered into whilst relations are harmonious. Agreements between friends, spouses and relatives are usually not contracts because the parties did not intend that they should be attended by legal consequences.

***Balfour v Balfour* [1919] 2 KB 571**

Facts

Mr and Mrs Balfour were holidaying in England. The husband returned to Sri Lanka. The wife, for health reasons, remained in England.

Before leaving, the husband promised his wife to pay £30 per month until such time as she joined him in Sri Lanka. The reunion did not eventuate because the parties eventually agreed to live apart. The husband failed to keep up the payments. The wife sued for breach of his promise.

Decision

The agreement was not enforceable because the parties did not intend to create legal relations. In the absence of the parties expressly declaring their intention to be bound by the arrangement made between them, the presumption relating to social or domestic agreements must apply – the parties did not intend to be legally bound by what they agreed on. The arrangement here was one involving matters of a domestic nature and there were no facts to rebut the presumption.

The following case is to be distinguished from *Balfour v Balfour*.

***Merritt v Merritt* [1970] 2 All ER 760**

Facts

Mr. and Mrs. Merritt were married. After many years of marriage, the husband left the wife to live elsewhere. At that time, the home was in the joint names of the husband and wife, and was subject to an outstanding mortgage. On 25 May 1966, they met and talked the matter over. The husband said that he would pay the wife £40 a month out of which she must make the outstanding mortgage payments on the house. The husband put down in writing a further agreement on a piece of paper. He wrote: 'In consideration of the fact that you will pay all charges in connection with the house... until such time as the mortgage repayment has been completed, when the mortgage has been completed I will agree to transfer the property in to your sole ownership.' The husband signed and dated that agreement.

In the following months the wife paid off the mortgage but the husband refused to transfer the house to the wife.

Decision

The written agreement of 25 May 1966 was intended to create legal relations between the parties because the husband and wife were separated or about to separate. The surrounding circumstances in the case showed that the parties did intend to create legal relations.

Rebuttable Presumptions

However, the presumptions may be rebutted by evidence to the contrary.

For example, circumstances may indicate that the parties to an arrangement that *appears* to be social or domestic may be legally bound if evidence shows that, when the agreement was made, they intended to be bound by it.

***Wakeling v Ripley* (1951) 51 SR (NSW) 183**

Facts

Mr. Ripley was an elderly man who lived by himself in Sydney. He promised his sister and brother-in-law (the Wakelings), who lived in England that if they came to live with him in his house in Australia, he would let them live rent free and leave them his house upon his death in his will. Mr. and Mrs. Wakeling agreed to the proposition and moved in with Mr. Ripley. To move, Mr. Wakeling resigned from his position at work and giving up his salary and pension, and they sold their property in England. After about a year, the relationship broke down. Mr. Ripley sold his house and the Wakelings were excluded from will. The Wakelings sued for breach of contract.

Decision

The Court found this was a case where there was evidence to rebut the presumption that there was no intention to be legally bound in a domestic agreement. The Wakelings had changed their position detrimentally in reliance on the agreement and Mr Ripley was aware of this. The seriousness of the move to Australia for the Wakelings demonstrated that the parties intended to be legally bound by the agreement.

The Objective Approach

In *Ermogenous v Greek Orthodox Community of SA Inc* (2002) 209 CLR 95, the High Court of Australia has indicated recently that presumptions are of limited value. The court preferred an objective assessment of the situation, in favour of what did the parties actually intend.

Therefore, in determining if there is contractual intent an objective approach should be taken. When taking an objective approach, the courts will look towards all the evidence that is available that would lead a reasonable person to conclude, on the balance of probabilities, that the parties did actually hold the intention to create a contract. If the evidence points to an intention to create legal relations, then the essential element of intention has been proven.

The courts will determine intention by looking towards any/the presence of physical evidence, and may examine the following:

- any written evidence in relation to the agreement;
- the language used by the parties;
- the relationship of the parties;
- the effect or consequences of the agreement on the parties;
- the conduct of parties e.g. parties subsequently acted as if agreement is binding; and
- the surrounding circumstances.

Intention to create legal relations is always a matter to be proved.

Consideration

Consideration must be present in all simple contracts for the contract to be valid. Consideration is an act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable. In other words, consideration is the 'something for something', the price or the exchange of promises from each party – from the promisor to the promisee – which turns an agreement into a contract. With every contract, one party receives something of value in return for providing something of value. Consideration turns an agreement into a contract. Basically, this means that there must be a reciprocal exchange.

The usual **bilateral** contract involves an exchange of promises which is sufficient. If I offer you ten kilograms of apples to be delivered to your house next Friday, payment of \$50 on delivery and you then agree (you accept my offer), we have exchanged reciprocal promises. I have promised to deliver the apples and you have promised to pay on delivery. If we ask – what is it that makes my promise to deliver legally binding? The answer is that it is supported by a good consideration, namely, your promise to pay on delivery. If we ask – what is that makes your promise to pay on delivery legally binding? The answer is my promise to deliver.

In **unilateral** contracts, consideration is provided for the promise of reward by an act, rather than a promise. This is sufficient. Remember, there is only promise from one party in unilateral contracts.

So, the exchange is constituted by a promise in exchange for a counter-promise (bilateral) or an act (unilateral). This incidentally also incorporates the rules of offer and acceptance. They are directed at a somewhat different enquiry, namely, whether an agreement has been made but they tie in with the doctrine of consideration because the exchange inherent in the process of offer and acceptance also provides the consideration. Acceptance is either a promise or an act.

Fundamental rules on consideration:

- Consideration must be sufficient but need not be adequate.
- Consideration must not be something the person is already obliged to do.
- Consideration can be 'executed' (present) or 'executory' (future) but it cannot be 'past'
- Consideration must be definite.

Consideration must be sufficient but need not be adequate

Consideration must have some legal value in the eyes of the law (sufficient), even if it is not equal to the value of what is being received in return (adequate). For example, a promise to pay a small amount of money or to perform a service can be sufficient consideration, even if it seems inadequate compared to what the other party is offering.

The law leaves the parties free to make their own bargain and the validity of a contract is not affected by a bad bargain. The attitude of the courts was that the law's primary role is to provide a framework within which businesspeople can carry out their commercial activities. The law should not extend beyond this function. The courts do not see it as their responsibility to adopt a paternalistic role in overseeing business transactions. If, for example, an individual chooses to sell their house for a nominal sum, such as a peppercorn, that decision is considered their personal business. Furthermore, allowing every transaction to be challenged on the grounds of fairness would undermine certainty in commercial dealings, which is essential for the smooth functioning of business.

Consideration must not be something the person is already obliged to do

Consideration cannot be something that a person is already legally obligated to do. A promise to perform a duty already imposed by contract is not good consideration. Consideration must involve offering something new or different from what one is already bound to perform under an existing duty or contract.

Stilk v Myrick [1809] 170 ER 1168

Facts

Two seamen deserted, and the captain, who could not get replacement crew, promised to divide the wages of the deserters among the remaining nine members of the crew if they completed the voyage.

Decision

The captain's promise to the crew was not supported by consideration by the crew and the agreement with the crew did not become a contract. The crew were already under an existing contract to sail the ship, to sail it back to London and to do any extra duties in an emergency (such as crew deserting or dying). The crew were still bound by their original contract.

If it can be shown that the promisee did something extra – something more than the existing duty – there may be good consideration for a new contract.

Consideration can be 'executed' or 'executory' but it cannot be 'past'

For a contract to be valid, consideration must be either executed or executory.

Consideration is '**executory**' if there is an exchange of promises to do something in the future. For example, A promises to deliver goods in the future in return for B's counter-promise to pay for them when they are delivered. A promise is made by one party in return for a promise of the other, and each promise is consideration for the other. If consideration is executory, the contract is effective as soon as the promises are exchanged. If A does not deliver the goods, there is a breach of contract and B can sue A. If A delivers the goods, A's consideration becomes executed.

If A makes a promise in exchange for an act by B, consideration is **executed** when B completes the act. For example, A offers a \$50 reward to anyone who finds and returns A's lost dog (this is a unilateral contract). If B finds the dog and returns it, B's act is both acceptance of the offer and executed consideration. A's promise to pay the reward remains outstanding. B has performed B's part and B's consideration is executed.

Consideration cannot be **past**. Past consideration is a promise given after an act has been carried out – past consideration is no consideration. This means that you cannot make a contract if what the other person is offering is something that they have already done in the past.

***Roscorla v Thomas* (1842) 3 QB 234**

Facts

A horse was sold by the defendant to the plaintiff for £30. After the sale, the seller promised that the horse was sound and free from vice. It turned out that the horse was in fact "very vicious, restive, ungovernable and ferocious". Is the promise relating to quality of the horse legally enforceable?

Decision

The original sale was simply a sale without a promise relating to quality. Such a promise (at that time) could not be implied as part of the original bargain. The express promise of quality was made after the deal. Nothing by way of consideration supported this promise. The plaintiff's consideration (buying the horse) was past consideration for the promise relating to quality. The consideration was used up – it did not support the later promise. For the promise to be enforceable, the plaintiff would have had to give fresh consideration for it.

In *Roscorla v Thomas*, the buyer could have secured a promise about the horse's temperament at the time of the deal, although the seller might have then asked for a higher price. Alternatively, the buyer could have obtained the promise after the deal was finalised by paying an additional amount for the benefit. This is similar to purchasing a washing machine, where the retailer may offer a separate enhanced guarantee for an extra fee.

Consideration must not be illegal or unlawful

Consideration must not involve anything illegal or unlawful. For a contract to be valid, the consideration exchanged must be legal and comply with the law; otherwise, the agreement is unenforceable.

For example, if one party agrees to perform an illegal act, like committing a crime in exchange for payment, that promise would not constitute valid consideration. Contracts based on such agreements would not be legally enforceable because they are contrary to public policy.

Consideration must be definite

It is important that consideration be definite and not be so vague as to be illusory and not real. The court will not enforce vague or indefinite promises in a contract. The court must be able to identify the consideration with sufficient certainty of meaning for it to be enforceable. Consideration provided has to be definite because the court must be able to place a legal value on it. If the court cannot do this, it will characterise the consideration provided as so vague as to be illusory and therefore to be no consideration at all.

References

Chew, C 2014, *Business Law Guidebook*, OUP, Melbourne, Australia.

Ciro, T, Goldwasser, V & Reeta V 2014, *Law and Business*, Oxford University Press, South Melbourne, Victoria, Australia.

Latimer, P 2016, *Australian Business Law 2016*, CCH Australia, Sydney, NSW, Australia.



Tutorial Questions

Students must complete the following questions before coming to class

Consideration

1. Match each of the following terms and concepts with the correct short explanation.

| Terms and concepts | |
|--------------------|--------------------------|
| A | Consideration |
| B | Executed consideration |
| C | Executory consideration |
| D | Past consideration |
| E | Sufficient consideration |
| F | Adequate consideration |

| Short explanations | |
|--------------------|---|
| | A promise for a promise |
| | Consideration of some legal value |
| | Consideration of equal value |
| | The price paid for a promise |
| | A promise for an act that has been done |
| | An act for a promise |

Rules as to Consideration and Intention to Create Legal Relations

2. Match the case to the relevant legal principle.

| Cases | |
|----------|---|
| A | <i>Roscorla v Thomas</i> (1842) 3 QB 234 |
| B | <i>Stilk v Myrick</i> (1809) 170 ER 1168 |
| C | <i>Balfour v Balfour</i> [1919] 2 KB 571 |
| D | <i>Merritt v Merritt</i> [1970] 2 All ER 760 |
| E | <i>Wakeling v Ripley</i> (1951) 51 SR (NSW) 183 |

| Principles | |
|------------|---|
| | There is a presumption in law that parties to a domestic arrangement do not intend to create legal relations. |
| | Domestic/Social presumption may be rebutted if the consequences for the parties were very serious. |
| | Parties doing what they were already contractually bound to do is not sufficient consideration. |
| | Past consideration is not valid consideration. |
| | Where spouses have separated it is generally considered that they do intend to be bound by their agreements. |

Consideration

3. Read the given scenarios below.

- For each scenario, identify the type of consideration involved, and whether the consideration is valid.
- Provide a brief explanation for your answer, highlighting the key characteristics that define each type of consideration.

Alex, a freelance graphic designer, enters into several agreements over the course of a month. Each agreement involves different types of consideration.

| Fact scenario | (a) What type of consideration is involved here? (executed, executory or past) Is the consideration valid? | (b) Explanation |
|---|--|--------------------|
| Alex agrees to design a logo for a local bakery. The bakery pays Alex \$500 upfront, and Alex completes the logo design the next day. | | |
| Alex had previously designed a website for a friend as a favour. A month later, the friend offers to pay Alex \$300 for the work already done. | | |
| Alex signs a contract with a tech startup to create a series of promotional graphics. The startup agrees to pay Alex \$1,000 upon completion of the project, which is scheduled for next month. | | |

| Fact scenario | (a) What type of consideration is involved here? (executed, executory or past) Is the consideration valid? | (b) Explanation |
|---|--|--------------------|
| Alex agrees to design a business card for a client in exchange for \$50. The client pays the agreed amount, and Alex delivers the business card design. | | |
| Alex agrees to design a full branding package (including logo, business cards, and website) for a new company. The company offers to pay Alex \$100 for the entire package, which is significantly below market rate. | | |

Intention to Create Legal Relations

- For a contract to exist the parties to an agreement must intend to create legal relations. Outline the different approaches courts use to determine whether parties have intention to create legal relations.

Intention to Create Legal Relations

5. Read the given facts below. Use the IPAC method to analyse the case.

X and Y are sisters. X promises Y she will pay Y \$40,000 in return for Y's promise to work on X's farm for one year. To fulfil her promise Y will be unable to complete her university degree.

Do the parties have an intention to create legal relations?

Issue/s:

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What is the main legal question or problem that needs to be resolved?

Identify the specific issue in dispute.

Principle/s and Application:

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What are the relevant laws or legal principles that apply to this issue?

State the rules or legal principles that govern the issue. This includes relevant statutes and/or case law.

How do the legal principles apply to the facts of the case?

Analyse how the legal principles interact with the specific facts. Clearly explain how each fact relates to the legal principles you have identified.

Integrating Principles and Applications: Immediately follow the principle with an application. For each new principle, repeat the process.

Conclusion:

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What is the outcome based on your analysis?

State the final decision. Conclude whether the issue is resolved in favour of one party or another based on the application.

Consideration

6. Read the given facts below. Use the IPAC method to analyse the case.

X gives Y a lift home in her car. On arrival Y promises to give X \$10 for the petrol. However, the payment was not made.

Was Y's promise to pay \$10 enforceable?

Issue/s:

What is the main legal question or problem that needs to be resolved?

Identify the specific issue in dispute.

Principle/s and Application:

What are the relevant laws or legal principles that apply to this issue?

State the rules or legal principles that govern the issue. This includes relevant statutes and/or case law.

How do the legal principles apply to the facts of the case?

Analyse how the legal principles interact with the specific facts. Clearly explain how each fact relates to the legal principles you have identified.

Integrating Principles and Applications: Immediately follow the principle with an application. For each new principle, repeat the process.

Conclusion:

What is the outcome based on your analysis?

State the final decision. Conclude whether the issue is resolved in favour of one party or another based on the application.

Valid Contract

7. Read the given facts below. Use the IPAC method to analyse the case.

Charlotte's jewellery shop has been burgled many times over the past few months. Finally, after the most recent incident last week, Charlotte rang the local police station and explained to the officer in charge what had happened. Theo, a police officer, was sent to be in charge to Charlotte's jewellery shop to make the necessary investigations. Charlotte said to Theo "If you can find the thief and have them arrested, I will reward you with \$2,000."

Theo worked very hard on the case and after 2 weeks, he found the thief and had him arrested. Theo asked Charlotte for the \$2,000 reward. Charlotte refused to give Theo the money.

Advise Theo as to his contractual rights.

Issue/s:

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What is the main legal question or problem that needs to be resolved?

Identify the specific issue in dispute.

Principle/s and Application:

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What are the relevant laws or legal principles that apply to this issue?

State the rules or legal principles that govern the issue. This includes relevant statutes and/or case law.

How do the legal principles apply to the facts of the case?

Analyse how the legal principles interact with the specific facts. Clearly explain how each fact relates to the legal principles you have identified.

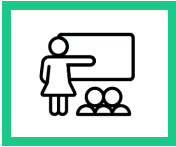
Integrating Principles and Applications: Immediately follow the principle with an application. For each new principle, repeat the process.

Conclusion:

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What is the outcome based on your analysis?

State the final decision. Conclude whether the issue is resolved in favour of one party or another based on the application.



In-Class Collaboration and Presentations

Students must read the following questions before coming to class.

Contract

In this activity, you are required to analyse a given fact scenario using the IPAC method (Issue, Principle, Application, Conclusion) and present your answer to the class in small groups.

Instructions:

1. Form small groups:

- Your tutor will divide the class into small groups of 3-5 students.

2. Understand the fact scenario:

- Carefully read the provided fact scenario.

3. Use the IPAC method to analyse the scenario:

- **Issue:**
 - What is the main legal question or problem that needs to be resolved?
 - Identify the specific issue in dispute.
- **Principle:**
 - What are the relevant laws or legal principles that apply to this issue?
 - State the rules or legal principles that govern the issue. This includes relevant statutes and/or case law.
- **Application:**
 - How do the legal principles apply to the facts of the case?
 - Analyse how the legal principles interact with the specific facts. Clearly explain how each fact relates to the legal principles you have identified.

Integrating Principles and Applications: Immediately follow the principle with an application. For each new principle, repeat the process.
- **Conclusion:**
 - What is the outcome based on your analysis?
 - State the final decision. Conclude whether the issue is resolved in favour of one party or another based on the application.

4. Prepare your presentation:

- Assign roles within your group (e.g., who will present each part of the IPAC method).
- Create a clear and concise presentation that covers each part of the IPAC method.

5. Present to the class:

- Each group will have 5-10 minutes to present their analysis.
- Ensure that each member of the group participates in the presentation.
- Be prepared to answer questions from your classmates and your tutor.

Fact scenario

Peter runs a guitar shop. He places an advertisement in the local newspaper that reads “Guitar for sale, \$5,500”. Peter’s son, Billy, responds to the advertisement by calling him and indicating that he will buy the guitar for \$5,300. Peter refuses, but informs Billy he will accept \$5,400. Billy will only pay \$5,400 if Peter includes a guitar stand. Peter agrees to these terms.

Peter’s daughter, Emma, contacts him and offers \$5,450 for the guitar. Is he able to accept this offer and sell the guitar to Emma?

Advise Peter as to his contractual rights.

Issue/s:

What is the main legal question or problem that needs to be resolved?

Identify the specific issue in dispute.

Principle/s and Application:

What are the relevant laws or legal principles that apply to this issue?

State the rules or legal principles that govern the issue. This includes relevant statutes and/or case law.

How do the legal principles apply to the facts of the case?

Analyse how the legal principles interact with the specific facts. Clearly explain how each fact relates to the legal principles you have identified.

Integrating Principles and Applications: Immediately follow the principle with an application. For each new principle, repeat the process.

Conclusion:

What is the outcome based on your analysis?

State the final decision. Conclude whether the issue is resolved in favour of one party or another based on the application.