

# Foundation Studies

# Business Environments

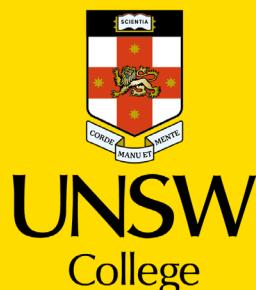
Part 2: The Legal Environment of Business

## Unit 5

Contract Law (II)

Lecturer:

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# Overview

- Essential elements of a valid contract (*continued*)
  - Intention to create legal relations
  - Consideration
- Using the IPAC method to answer contract problem questions

# Cases in this unit

*Roscorla v Thomas*

*Stilk v Myrick*

*Balfour v Balfour*

*Merritt v Merritt*

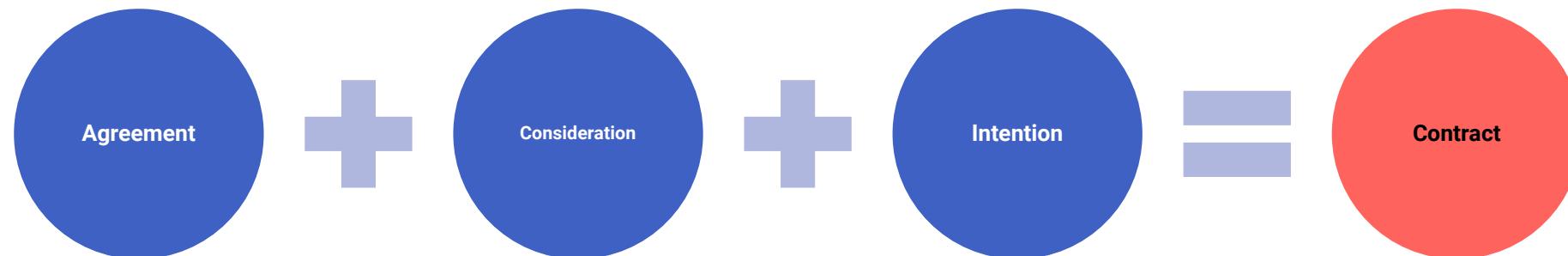
*Wakeling v Ripley*

*Ermogenous v Greek Orthodox Community of SA Inc*

# Formation of Contract

## Essential elements of a valid contract

- Agreement = Offer + Acceptance (See Unit 4)
- Consideration
- Intention to create legal relations



# Consideration



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# Consideration

- Consideration is something of legal value that has been exchanged for a promise
- “Price” paid/given in return for a promise
- Essential/necessary in every simple contract
- Promisee must provide consideration for the promise they have received
  - No consideration:
    - No contract
    - Promise unenforceable
- Consideration may assist to determine whether parties intended to create legal relations (see Intention to create legal relations)

# Consideration

## Types of consideration

- **Executory** (Future)
  - Consists of a promise to do something
    - E.g. X promises to pay Y in return for Y's promise to wash X's car
- **Executed** (Present)
  - Takes the form of performing a required act
    - E.g. *Carlill v Carbolic Smoke Ball*
- **Past**
  - Consideration pre-dates the promise
    - E.g. X promises to pay Y after Y has completed the work

# Consideration

## Rules relating to Consideration

- **Consideration may be “executed” or “executory” but cannot be “past”.**  
Past consideration is an act or benefit given or performed before a promise is made, which cannot be used as valid consideration for that promise.

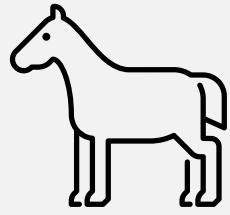
# Consideration

**Past consideration is not valid consideration**

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

## Facts

- Roscorla purchased a horse from Thomas for £30.
- After the sale was completed, Roscorla asked Thomas about the condition of the horse. Thomas promised that the horse was 'sound and free from vice'.
- Horse turned out to be aggressive, bad tempered and difficult to control.
- Plaintiff sued for breach of contract.



# Consideration

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

### **Issue**

- Is the promise (horse was sound) legally enforceable?
- Decision
- No, the promise was not enforceable.
  - The past act of paying the purchase price had occurred before Thomas's promise was made, and was therefore past consideration. It did not constitute valid consideration to enforce the new promise.
  - No new consideration was not given in exchange for the promise.

# Consideration

## **Consideration must be sufficient**

- Consideration must have legal value

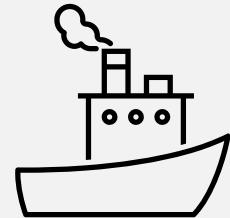
# Consideration

**Consideration must amount to something more than party already obliged to do**

***Stilk v Myrick [1809] 170 ER 1168***

## Facts

- Plaintiff – one of 11 seaman
- During the voyage, 2 seamen deserted. Myrick, the captain of the ship, could not find replacements for them.
- Captain promised remaining seamen extra wages if they continued to work the ship back to London



# Consideration

## ***Stilk v Myrick [1809] 170 ER 1168***

### **Issue**

- Was the agreement to pay extra wages a binding contract?

### **Decision**

- The seamen were already contractually obligated to work the ship back to London, and thus the captain's promise of extra payment was not supported by new consideration.

# Consideration

## Consideration need not be adequate

- Law is not concerned with whether the exchange is equally beneficial to both parties

# Consideration

- **Consideration must not be illegal or unlawful**
  - For example, If two parties agree to enter into a contract for the sale of illegal drugs, the consideration is unlawful.
- **Consideration must be definite, clear, certain**
  - For example: A promises to pay B ‘an amount or at a rate determined by A from time to time which may or may not change and payment cannot be guaranteed at any time’ is a promise that has no certainty.

# Consideration (Examples)

X has a car. Its market value is \$5,000.

**Y pays X \$5,000**

Consideration is adequate

Consideration is sufficient

Valid contract

**Y pays X \$100**

Consideration is inadequate

Consideration is sufficient

Valid contract

**X promises to give car to Y for free**

No consideration

Gift/Gratuitous promise

No valid contract unless formal contract created

# **Intention to Create Legal Relations**



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# Intention to Create Legal Relations

- There must be clear intention by the parties that the agreement is intended to be enforceable in law
- Intention is:
  - Seldom stated
  - Inferred from circumstances  
(Example: Actions of parties)

# Intention to Create Legal Relations

## 2 rebuttable presumptions

### Business agreements

Presumed that parties intend to create legal relations

### Family, domestic or social agreements

Presumed that parties do not intend to create legal relations

Both presumptions are capable of being **rebutted** (overturned)  
by evidence to the contrary

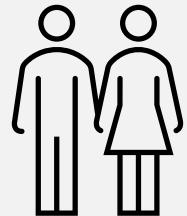
# Intention to Create Legal Relations

## Social/Domestic arrangements

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

### Facts

- Husband promised to pay wife £30/month while she remained in England due to illness, and he returned to Sri Lanka
- When the agreement was made, the parties were on amicable terms
- They later separated, and the husband stopped the payments.



# Intention to Create Legal Relations

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

### **Issue**

- Was Mr Balfour's promise to pay £30/month allowance legally enforceable?

### **Decision**

- Agreement was not enforceable
- This was an agreement between spouses – the parties, in the inception of the arrangement, never intended that they should be sued upon

# Intention to Create Legal Relations

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

### Facts

- The parties held their matrimonial home in joint names.
- Husband and wife subsequently separated.
- Husband wrote, signed and dated a document stating that in consideration of wife paying the mortgage until it was paid off, he agreed to transfer the matrimonial home into her sole name.
- Wife paid off mortgage; husband refused transfer.



# Intention to Create Legal Relations

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

## Issue

- Was the agreement legally enforceable?

## Decision

- A written agreement between a separated married couple was legally enforceable. The court distinguished this case from social or domestic agreements by emphasising that the couple was separated and, therefore, intended to create legal relations.

# Intention to Create Legal Relations

**Presumptions may be rebutted by evidence to the contrary**

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

## Facts

- Ripley (living in Australia) persuaded his sister and her husband (the Wakelings) to move to Australia from England to live with him; promised to include Wakelings in his will.
- To move, Wakeling resigned from his position at work and giving up his salary and pension.
- After about a year, the relationship broke down and Wakelings were excluded from will.

# Intention to Create Legal Relations

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

## Issue

- Whether the agreement between the family members was legally enforceable.

## Decision

- 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.
- Economic seriousness of the situation: Wakelings had changed their position detrimentally in reliance on the agreement and Ripley was aware of this.
- There was an intention on behalf of the parties to be legally bound; agreement was legally enforceable.

# Intention to Create Legal Relations

## Commercial/Business arrangements

- The commercial presumption can be rebutted:
  - by the circumstances of the case
  - when parties expressly excluded legal relations
- The court will, in the absence of express words to the contrary, normally hold that legal relations were intended
- It is rare for the conclusion to be drawn that the parties in commercial arrangements did not intend their agreement to be attended by legal consequences

# Intention to Create Legal Relations

## Use of presumptions of limited value

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

# Intention to Create Legal Relations

## Objective approach

Whether a reasonable person would expect legal obligations in the circumstances?

- Court will look at the facts and circumstances surrounding the agreement, including:
  - What was agreed? Was the agreement in writing?
  - Language used by the parties
  - Relationship of parties
  - Effect of agreement on parties
  - Conduct of parties e.g. parties subsequently acted as if agreement is binding
  - The surrounding circumstances
- The court is not concerned with whether the parties actually/subjectively intended to be legally bound

# Exercises



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# **Exercise 1**

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Batul and Frankie arrange to spend a week together at Noosa over the Christmas break. Frankie tells Batul that she will hire a sports car and drive them to Noosa if Batul books and pays for the accommodation. Batul takes the week off work, books and pays for the accommodation. On the day of departure, however, Frankie tells Batul that she has decided to spend the week in Sydney with her friends.

**Advise Batul as to intention to create legal relations.**

**In your answer, you must consider and apply any relevant decisions from any relevant cases you have studied.**



## Exercise 2

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Lachlan's pharmacy had been broken into many times in the past few years. Finally, after a robbery last month, Lachlan rang the local police station and explained what had happened. The police station sent Jay, a police officer, to Lachlan's pharmacy to make the necessary investigations. Lachlan said to Jay: '*If you can investigate and arrest the thief, I will reward you with \$2,000.*'

Jay conscientiously worked on the case. After two weeks of sustained effort, he had found the thief and had him arrested. Jay asked Lachlan for the \$2,000 reward. Lachlan refused to give Jay the money.

**Advise Jay as to consideration.**

**In your answer, you must consider and apply any relevant decisions from any relevant cases you have studied.**



# **End of Lecture**

Next week:  
The Legal Environment of Business: Tort of Negligence (I)



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