

BUSINESS LAW GUIDEBOOK

SECOND EDITION

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CHAPTER 3: FORMATION OF CONTRACT

TEST YOUR KNOWLEDGE

1. 'Contract law is based on the concept of a bargain'. Explain.

ANSWER

Contract law is based on the concept of a bargain because it involves agreements between parties settling what each shall give and take, or perform and receive, in a transaction.

2. Why do parties require an intention to create legal relations to contract?

ANSWER

Parties require an intention to create legal relations so that their agreement is contractual and therefore enforceable in the courts in the event of a dispute.

3. Discuss the presumptions which apply to (a) domestic or social agreements and (b) commercial agreements.

ANSWER

The presumption which applies to domestic or social agreements is that these agreements do not intend any legal obligations to arise. The presumption which applies to commercial agreements is that the parties do intend to be legally bound by what they promised. Both

these presumptions can be rebutted by evidence which indicates an intention to the contrary.

4. 'Consideration must move from the promisee'. Discuss.

ANSWER

This means that any person wishing to enforce a promise, that is, the promisee, has to demonstrate that he or she has provided something of value in exchange for that promise. That is to say, the promisee must show that he or she has paid a price for the promise breached.

5. Distinguish between 'executed', 'executory' and 'past' consideration.

ANSWER

Consideration is said to be 'executed' when a party to a contract has performed his or her obligations under that contract (that is, in exchange for the other party's promise). For example, if John offers Tom \$50 to mow John's lawn, when Tom has mowed the lawn, Tom's consideration is said to be executed. Consideration is said to be executory where one party has given a promise to do or refrain from doing something in exchange for the other party's promise. All that the parties have done is exchange promises. Consideration is said to be past when the promise is made after the performance of an act and independently of the act. It is said that past consideration is no consideration. What this means is that consideration must be given contemporaneously with the promise sought to be enforced.

6. The decision in *Ermogenous v Greek Orthodox Community* has an effect on the question of intention to create legal relations. Discuss briefly.

ANSWER

The High Court in *Ermogenous v Greek Orthodox Community* questioned the 'utility of using the language of presumptions' [at 26] thus doubting the usefulness of the 'presumptions' principle in determining legal intentions. It argued that the issue was to establish the existence of a legally binding contract between the parties. The question of whether the parties had the requisite legal intention should now be decided by looking at what the parties said, at what they did, and at the circumstances in which they arrived at their agreement to ascertain, as objectively as possible, whether they truly intended it to be contractual.

Accordingly, the real question will now be quite complex, and not just based on simple presumptions. The court needs to make an objective assessment of statements and actions by both parties. There is the importance of proof with the party who asserts that there is a legally binding contract having the burden of showing that it was what the parties really intended.

7. It is said that consideration must not be vague. Discuss.

ANSWER

It is important that consideration must be identified with certainty. What this means is that it must be clear that the consideration provided is definite and that, as a result, the court is able to place a legal value on it, no matter how small or inadequate. If the court is unable to do so, it will declare the consideration provided to be so vague as to be illusory and therefore no consideration at all. See *Placer Development Ltd v Commonwealth* (1969) 121 CLR 353.

8. What do you think is meant by saying consideration must be sufficient?

ANSWER

Although consideration need not be adequate, it must be sufficient. The question of sufficiency should be distinguished from the question of adequacy. So long as consideration exists, the courts will not be concerned about its adequacy. But it must be sufficient, that is, it must have some legal value, or it must be considered insufficient and no consideration at all. The situations in which the question of sufficiency of consideration has been an issue are, for example, promise to perform a moral obligation; promise not to sue; performance of an existing contractual duty owed to the promisee.

9. What are the changes in the application of promissory estoppel as a result of the decision of the High Court in *Waltons Stores (Interstate) Ltd v Maher*?

ANSWER

The changes are as follows:

- Promissory estoppel may now be used in one of two ways—as a shield, to defend an action, and also as a sword, to commence an action.

- There is no necessity to have a pre-existing contract.
- The use of promissory estoppel in the way permitted by the High Court effectively negates both the requirement that consideration is required in simple contracts, and that it must move from the party suing to the party being sued.
- There must be evidence of detriment being suffered by the innocent party.
- Unconscionability would be an issue if the defendant were allowed to go back on their representation.

10. Explain whether the promises in each of the following agreements are enforceable:

(a) Michael's niece Nina promised him that he could use her expensive tennis racket if he will help her out with her high school assignment. Michael helped Nina all Saturday morning to complete her assignment, but Nina refused to let him use her tennis racket.

ANSWER

Michael can enforce the agreement because he has provided consideration for Nina's promise by helping her out with her high school assignment.

(b) John, who owns a sandwich shop, promised to increase Anna's wages, but later decided he could not afford to and broke his promise.

ANSWER

This agreement is not enforceable because Anna has not provided consideration.

(c) Peter owes Olivia \$250. He cannot pay and offers \$50 and a box of pencils in full settlement. At first Olivia accepts but later demands the balance.

ANSWER

Olivia cannot demand the balance. Here the doctrine of promissory estoppel operates because Olivia originally promises to accept Peter's payment of \$50 and a box of pencils in full settlement of the debt, but later decides to enforce her strict legal rights under the agreement. As a result, Peter acts on Olivia's original representation and alters his position (and suffers a detriment) accordingly: *Waltons v Maher* (1988) 164 CLR.

11. Explain what is meant by the term ‘necessaries’.

ANSWER

The term ‘necessaries’ means goods and services suitable to an infant’s condition in life, without which the infant cannot reasonably exist. It includes necessary food, drink, clothing, medicine, lodging and education.

12. Can minors form a legally binding contract?

ANSWER

Minors can certainly form a legally binding contract. It has to consist of the supply of ‘necessaries’ and has to be a beneficial contract of service.

13. Explain what must be proved by a party who is attempting to avoid being bound by a contract on the grounds of mental illness or intoxication.

ANSWER

Parties who are attempting to avoid being bound by a contract on the grounds of mental illness or intoxication must show that: (i) at the time of contracting they were so disabled (whether through mental illness or intoxication) that they did not understand what it was that they were doing; and (ii) the other party was either aware or ought to have been aware of the existence of one or the other condition: *Lampropoulos v Kolnick* [2010] WASC 163; *Blomley v Ryan* (1956) 99 CLR 362.

14. What is the underlying purpose of the privity of contract rule?

ANSWER

The underlying purpose of the rule is that only the parties to the contract can acquire legally enforceable rights or incur legally enforceable obligations under it. Therefore a stranger to a contract cannot take advantage of provisions of the contract, although it is clear from the contract that some provisions in it were intended to benefit him or her. The parties to a contract cannot enforce obligations against a stranger.

PROBLEM QUESTION

Before you attempt the following problem, make sure you read the 'Guidelines for answering problems' and be acquainted with the IPAC method of writing answers to problem questions.

PROBLEM

Ken's pharmacy had been broken into many times in the past few years. Finally, after a robbery last month, Ken rang the local police station and explained what had happened. The police station sent Eric, a police officer, to Ken's pharmacy to make the necessary investigations. Ken said to Eric: 'If you can find the thief I will reward you with \$2000.'

Eric conscientiously worked on the case. After two weeks of sustained effort, he had found the thief and had him arrested. He asked Ken for the \$2000. Ken decided to break his promise by refusing to give Eric the money. Advise Eric.

ANSWER

This problem question has to do with consideration, one of the essential elements needed to form a contract. **(Issue)**

Consideration is the price paid for a promise. It is also described as something done or promised by one party in exchange for something done or promised by the other party. However, where there is a promise by one party to perform an existing public duty required by contract, this is not consideration: *Stilk v Myrick*. **(Principle)**

From the facts given, Eric is a police officer and his duty is to apprehend criminals. Eric is only promising Ken to do what is already expected of him. **(Application)**

Therefore Eric cannot sue Ken for the \$2000, as he had offered no consideration, and there is no contract. **(Conclusion)**