

PART 1: CONTRACT LAW

¶1-005 Helpful hints

When faced with a question concerning contract law, it is important that you read the question carefully and ask yourself: *What is the question asking of me?* Although it might be tempting to write about all the legal principles relating to an aspect of contract law (eg contract formation), the question might only be asking you to focus your discussion on one or two legal principles. It is critical that you correctly identify what is being asked of you and that you answer the question accordingly. This applies to exams as well as the assessments that you are required to complete to obtain your final business law mark.

Most assessments (eg essays, exam questions) will specify a word limit. It is *essential* that you adhere to the word limit, otherwise you may be penalised (sometimes in the order of 10%) for exceeding the word limit assigned. To ensure that you do not exceed the word limit, focus on *only* addressing the legal principles that directly relate to the assessment question being asked. We will not be discussing completion of assessments any further in this book as students tend to have more difficulty with exams. There are many books and online resources available that offer advice and guidance on writing essays and assignments. Most universities also offer workshops and learning skills support in areas such as writing and research.

With any assessment, whether it is an exam question or other form of assessment, it is best to *read the question first* before reading the complete set of facts of the question. The question is usually situated at the end of the facts of the question. The reason why you should read the question first is so that you can identify the key facts in the question. These will assist you to answer the question and to disregard irrelevant facts. Once you have read the question, you can ascertain *what* the question is asking of you, and approach the facts with the question in mind.

¶1-010 Common errors

Following are some errors commonly made by students when answering questions in this area of law:

- *Students not reading the question carefully and not answering the question asked of them.*

With respect to the topic of contract formation, there are a number of possible questions that the examiner might ask relating to different aspects of contract formation. Read the question carefully and make sure you understand what the question is asking you to address.

- *Students stating the relevant legal principles without citing the underpinning case authorities or legislation.*

It is not enough to simply recite legal principles without also discussing the cases or legislation from which the legal principles are derived.

- *Students not taking care to carefully review the course materials, assessment instructions and assessment marking matrix or grid (if it is made available).*

Some courses will require you to not only cite the relevant case authorities or legislation, but also discuss the case authorities and/or legislation in detail. For instance, in addition to citing the relevant case authority, you may be required to discuss the facts, legal issue and judgment of the relevant case. The course materials, assessment instructions and assessment marking matrix or grid should specify what is expected of students. If you are uncertain as to whether you are required to discuss case authorities and/or legislation in detail, you should consult your lecturer or tutor.

- *Students stating the legal principles, case authorities and/or legislation, but not applying the law to the facts of the question.*

If you only recite the legal principles, case authorities and/or legislation, and you do not apply the law to the facts of the question, you have only effectively completed half of the task. Approximately half of the allocated assessment marks are allocated to your discussion of legal principles, case authorities and/or legislation. The remainder are allocated to your application of the law (ie your application of the law to the facts of the question). Therefore, if you do not apply the law to the facts of the question, you will not obtain a strong grade in your business law unit, despite knowing the law. In the study of law, application of law is just as important as knowledge of the law itself.

CONTRACT FORMATION

¶1-105 Snapshot of the law

To succeed in this topic you need to be familiar with the key elements of a legally binding agreement. For a legally binding agreement to exist, three elements must be present:

1. intention to form a legally binding agreement
2. agreement, and
3. consideration (in circumstances when the contract is not executed by deed).



Intention to form a legally binding agreement

A contract is only legally enforceable if the parties intended to be legally bound by the agreement. Put another way: Did the parties intend for the contract to be legally enforceable if either party did not perform their contractual obligations?

Intention to form legal relations must be either “express” or “implied”. Given such an intention is rarely explicitly expressed, courts will often be called upon to determine whether such intention can be implied in the given circumstances. To determine whether such implied intention existed, the court applies two objective presumptions:

1. Parties of a domestic or social relationship are assumed not to intend to enter into a legally binding agreement (ie parent and child, siblings, friends, etc) (*Balfour v Balfour* [1919] 2 KB 571).
2. Parties of a commercial/business relationship are assumed to intend to enter into a legally binding agreement (ie business partnerships, commercial contractors, etc) (*Esso Petroleum Ltd v Commissioners of Customs & Excise* [1976] 1 All ER 117).

Although the courts rely on the above presumptions, the presumptions can be rebutted, provided that the party wishing to rebut the presumptions can present evidence to the contrary (*Merritt v Merritt* [1970] 2 All ER 760 and *Commonwealth Bank of Australia v TLI Management Pty Ltd* [1990] VR 510).

Agreement

Where the parties have entered into a contract by way of a written document, it is rare that the existence of an agreement will be disputed. However, in circumstances where there is no written document (eg where the parties have instead communicated verbally and liaised through a variety of methods, such as through letter or email exchanges), it may be disputed whether an agreement has been reached.

An agreement is comprised of an “offer” and “acceptance”. To establish that an agreement exists, a court must be satisfied that an offer was made and that it was subsequently accepted unconditionally.

Offer

An offer is a statement, made by one party to another party, of the terms by which he or she is willing to be contractually bound. The person making the offer is referred to as the “offeror”. The person to whom the offer is addressed is the “offeree”. An offer must be a definitive statement made by the offeror to the offeree of the terms that he or she is willing to be bound by (*Harvey v Facey* [1893] AC 552).

Once the offer is accepted, an agreement is formed. Generally, the following examples lack certainty and so are not considered to be offers:

- puffs
- advertisements (*Partridge v Crittenden* [1968] 2 All ER 421)
- goods displayed on shelves (*Pharmaceutical Society v Boots Cash Chemist (Southern) Ltd* [1953] 1 QB 401)
- tenders, and
- auctions (*Harris v Nickerson* (1873) LR 8 QB 286).

Offers must be communicated *before* an offeree can accept the offer. Offers can be communicated in one of three ways:

1. directly to the offeree
2. to a group of people (which the offeree is a part of) (*R v Clarke* (1927) 40 CLR 227), or
3. to the world at large (*Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256).

An offer will lapse within a reasonable period of time (*Ramsgate Hotel Co v Montefiore* (1866) LR 1 Exch 109), provided the offer was not withdrawn prior to being accepted (*Routledge v Grant* (1828) 130 ER 920) or lapsed by virtue of a counter-offer (*Hyde v Wrench* [1840] 49 ER 132).

Acceptance

An acceptance is a statement of unconditional assent to the terms of the offer made by the offeror. Any acceptance that seeks to amend the terms upon which the offer was made is not a valid acceptance. The following statements are *not* considered to be acceptance:

- counter-offers (*Hyde v Wrench* [1840] 49 ER 132), and
- conditional acceptance (*Masters v Cameron* (1954) 91 CLR 353).

Only the offeree can accept the offer made by the offeror.

An agreement is formed once the acceptance has been communicated to the offeror. When and where the agreement is made will depend on the type of communication used.

Acceptance can be communicated through the following methods:

- *Verbally*: An agreement is formed once the offeror receives the offeree's acceptance.
- *Conduct*: An agreement is formed once the offeror receives the offeree's acceptance. However, in circumstances where an offer is made inviting potential offerees to accept the offer by carrying out specified tasks, an agreement is formed when the offeree performs the specified task (*Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256).
- *Post*: If indicated by the offeror, an agreement is formed once the acceptance letter is posted (*Henthorn v Fraser* [1892] 2 Ch 27).
- *Email*: An agreement is formed once the acceptance email is registered by the offeror's specified information system. (In Australia, this is regulated by state and territory legislation. See, for example, the *Electronic Transactions (Victoria) Act 2000*.)
- *Fax*: An agreement is formed once the acceptance fax is registered by the offeror's fax machine (*Brinkibon Ltd v Stabag Stahl und Stahlwarenhandels-gesellschaft mbH* [1983] 2 AC 34).

Consideration

In circumstances where the contract is not executed by deed, both parties must provide consideration. A contract is executed in deed where the contract is written, signed, witnessed, sealed and delivered by the parties to the contract.

Consideration is the promise provided by each party to the agreement. The consideration provided does not have to be of equivalent value to the consideration received in exchange. However, the consideration must have some legal value (*Eleanor Thomas v Benjamin Thomas* (1842) 2 QB 851). Therefore, consideration can be a promise to do or not do something, or provision of payment or an item in exchange for the promise received.

Consideration can be classified in the following ways:

- *Executed consideration*: This is a form of consideration where a party performs the consideration. For example, payment for a coffee immediately upon ordering (*Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256).
- *Executory consideration*: This is a form of consideration where a party promises to perform the consideration in the future. For example, a party promises to pay for a car once it has been delivered (*Musumeci v Winadell Pty Ltd* (1994) 34 NSWLR 723).
- *Past consideration*: This is consideration that has taken place in the past. Past consideration is not good consideration as the recipient does not stand to benefit from the consideration as the consideration has already occurred (*Roscorla v Thomas* (1842) 3 QB 234).

¶1-110 Question example

James Hues owns and runs a successful café and catering business, Café Express, in the heart of St Kilda, Melbourne. He is tired of working long hours and decides to sell Café Express. James contacts Williams and Associates Real Estate Agents (Williams and Associates) to arrange the sale of the business.

Williams and Associates place an advertisement in the local newspaper advertising Café Express for sale. The advertisement reads:

URGENT SALE

Café Express

Café Express, located in the heart of St Kilda (situated off Fitzroy Street), is available for sale. This rare business opportunity will not be on the market for long!

All furniture, equipment and current stock inclusive of the business sale.

Sales are approximately \$750,000 per annum (excluding GST) and owner-operator profits are approximately \$120,000 per annum (calculated based on the average earnings from the past five years).

All reasonable offers above \$350,000 will be considered. For more information or to make an offer, please contact John Williams on 0456 789 012 or enquiries@williamsandassociates.com.

Stephanie Shee, a close family friend of James, notices the advertisement in the newspaper and telephones James directly. Stephanie, knowing how much James wants to leave the hospitality industry, offers to purchase Café Express for \$300,000. As Stephanie's offer is \$50,000 below the minimum asking price, James is hesitant to accept the offer. Stephanie tells James to think

about her offer and to get back to her at the end of the week, but no later than the coming Friday at 5 pm.

Without consulting Williams and Associates about the offer, James decides to accept Stephanie's offer. On Wednesday morning, James emails Stephanie telling her that he is willing to sell Café Express to her for \$300,000.

On Wednesday afternoon, John Williams from Williams and Associates contacts James and informs him that an anonymous investor has provided a written offer to purchase Café Express for \$400,000. James tells John to accept the offer on his behalf.

James immediately calls Stephanie and tells her to ignore the email he had sent her earlier that day. Stephanie is very angry and believes that they have formed a legally binding contract.

¶1-115 Common questions assessed in this area of law

A question concerning contract formation will generally ask you one (or a combination) of the following questions:

1. Did the parties possess the necessary intention to form a legally binding agreement?
2. Did the parties reach an agreement (ie was an offer and acceptance reached)?
3. Is consideration required in the given circumstance and, if so, has sufficient consideration been provided?
4. Did the parties ultimately form a legally binding agreement?

¶1-120 Answer structure — Question 1

Q1: Have James and Stephanie demonstrated an intention to form a legally binding agreement?

Hint: The question asks you to only consider whether James and Stephanie have demonstrated an intention to form a legally binding agreement. Therefore, there is no need to discuss the other elements of contract formation, ie agreement and consideration.

Principles of law — checklist

Intention to form a legally binding agreement

- Define "intention to form a legally binding agreement".
- How do the courts determine whether a party intends to form a legally binding agreement?
- What presumptions do the courts apply in determining whether a party intends to form a legally binding agreement?
 - Are the parties of a domestic or social relationship? (*Balfour v Balfour* [1919] 2 KB 571)
 - Are the parties of a commercial or business relationship? (*Eso Petroleum Ltd v Commissioners of Customs & Excise* [1976] 1 All ER 117).
- Are the presumptions rebuttable?
 - Can a party demonstrate that, despite the parties' domestic or social relationship, the parties did intend to be legally bound to the agreement? (*Merritt v Merritt* [1970] 2 All ER 760 and *Commonwealth Bank of Australia v TLI Management Pty Ltd* [1990] VR 510).

Applying the law to the facts of the example question	
Intention to form a legally binding agreement	
<i>Relevant facts of the example question</i>	<i>Application of the law to the facts of the example question</i>
<ul style="list-style-type: none"> Stephanie is a close family friend of James. 	<ul style="list-style-type: none"> Applying the presumptions that the courts rely on to determine whether the parties intended to form a legally binding agreement: <ul style="list-style-type: none"> Are the parties of a domestic or social relationship? → Yes, James and Stephanie are close family friends. Are the parties of a commercial or business relationship? → No, but James and Stephanie appear to have entered into a commercial or business agreement. The agreement was for the sale of a business in exchange for \$300,000. Given that James and Stephanie have a social relationship, it is presumed that James and Stephanie did not possess the intention to form a legally binding agreement. However, it appears that the parties have entered into a commercial agreement as the agreement was for the sale and purchase of a business in exchange for a substantial amount of money, ie \$300,000. In the given circumstances, it is arguable that the presumption regarding parties of a social relationship is rebuttable as the parties did possess the intention to form a legally binding agreement.
<ul style="list-style-type: none"> Stephanie knows how much James wants to leave the hospitality industry. 	<ul style="list-style-type: none"> Is there evidence on the facts to suggest the presumption is rebuttable? → The fact that Stephanie is aware that James wants to leave the hospitality industry is not an indication of the closeness of their relationship. The advertisement placed by Williams and Associates advertising the sale of Café Express is an indication to the world at large of James's desire to leave the hospitality industry.
<ul style="list-style-type: none"> Stephanie offers to purchase Café Express for \$300,000, which is \$50,000 below James's minimum asking price. 	<ul style="list-style-type: none"> Is there evidence on the facts to suggest the presumption is rebuttable? → The fact that Stephanie offers to purchase Café Express for \$50,000 below the minimum asking price to which James accepts is not an indication of the closeness of their relationship. It is very common business practice to barter and make offers below the minimum asking price. Also, the offer to purchase Café Express for \$300,000 is a competitive commercial rate for a business.
<ul style="list-style-type: none"> James does not consult with Williams and Associates regarding Stephanie's offer. 	<ul style="list-style-type: none"> Is there evidence on the facts to suggest the presumption is rebuttable? → The fact that James did not consult Williams and Associates regarding Stephanie's offer is not common commercial practice. Although this fact does not assist in rebutting the presumption, it does not support the presumption either.

Reach a conclusion

Intention to form a legally binding agreement: Did the parties possess the necessary intention?

On the balance of probabilities, it appears that James and Stephanie did possess the necessary intention to form a legally binding agreement, despite being parties of a social relationship.

¶1-125 Answer structure — Question 2

Q2: Have James and Stephanie reached an agreement?

Hint: The question asks you to only consider whether James and Stephanie have reached an agreement. This is evident in the way the question is framed. The question does not ask you to consider the other aspects of contract formation, ie intention to form a legally binding agreement and consideration. Therefore, you should only focus your answer on addressing whether an agreement was reached between the two parties, namely whether an offer and acceptance was reached between the parties.

Principles of law — checklist

Agreement

- Define "agreement".

Offer

- Define "offer".
- Does the statement contain the terms that the offeror is willing to be contractually bound to? (*Harvey v Facey* [1893] AC 552).
- Are the terms of the offer definitive? If no, is the statement any of the following:
 - puffs?
 - advertisements? (*Partridge v Crittenden* [1968] 2 All ER 421)
 - goods displayed on shelves? (*Pharmaceutical Society v Boots Cash Chemist (Southern) Ltd* [1953] 1 QB 401)
 - tenders?, or
 - auctions? (*Harris v Nickerson* (1873) LR 8 QB 286).
- How was the offer addressed/made?
 - Was it directed to the offeree?
 - Was it directed to a particular class of people (which the offeree belonged to)? (*R v Clarke* (1927) 40 CLR 227)
 - Was it directed to the world at large? (*Carlill v Carbolic Smoke Ball Co* [1893] 1 QB 256).
- Is the offer still in existence?
 - Has the offer been withdrawn prior to the offeree accepting the offer? (*Routledge v Grant* (1828) 130 ER 920)
 - Has a reasonable period of time passed causing the offer to have lapsed? (*Ramsgate Hotel Co v Montefiore* (1866) LR 1 Exch 109)
 - Has the offer lapsed by virtue of a counter-offer? (*Hyde v Wrench* [1840] 49 ER 132).

Acceptance

- Define "acceptance".
- Was the offer addressed to the person seeking to accept it?

Principles of law — checklist	
<ul style="list-style-type: none"> ● Was the statement an unconditional assent to the terms of the offer? If no, is the statement any of the following?: <ul style="list-style-type: none"> ■ acceptance subject to a condition? (eg “subject to contract” term (<i>Masters v Cameron</i> (1954) 91 CLR 353)), or ■ a counter-offer? (<i>Hyde v Wrench</i> [1840] 49 ER 132). 	
<ul style="list-style-type: none"> ● Has the offeree communicated acceptance? If yes, which method did the offeree employ? (NB: This will effect when and where the agreement formed.): <ul style="list-style-type: none"> ■ verbal? ■ conduct? (<i>Carlill v Carbolic Smoke Ball Co</i> [1893] 1 QB 256) ■ post? (<i>Henthorn v Fraser</i> [1892] 2 Ch 27) ■ email? (see, for example, the <i>Electronic Transactions (Victoria) Act 2000</i>), or ■ fax? (<i>Brinkibon Ltd v Stahag Stahl und Stahlwarenhandels-gesellschaft mbH</i> [1983] 2 AC 34). 	

Applying the law to the facts of the example question	
Agreement	
<ul style="list-style-type: none"> ● To determine whether an agreement was reached between James and Stephanie, the legal aspects of offer and acceptance must be considered. 	
Offer: Who made the offer?	
<i>Relevant facts of the example question</i>	<i>Application of the law to the facts of the example question</i>
<ul style="list-style-type: none"> ● Williams and Associates placed an advertisement in the local newspaper advertising Café Express for sale. 	<ul style="list-style-type: none"> ● Does the statement contain the terms that the person is willing to be contractually bound? → Yes. ● Are the terms of the offer definitive? → No, the statement was an advertisement. ● How was the offer addressed/made? → Directed to a particular class of people. ● Is the offer still in existence? → Yes. ● The advertisement placed by Williams and Associates was not an offer because it did not satisfy the legal requirements of an offer as the terms of the offer were not definitive.
<ul style="list-style-type: none"> ● Stephanie offers to purchase Café Express for \$300,000. Stephanie tells James to think about her offer and to get back to her at the end of the week, but no later than the coming Friday at 5 pm. 	<ul style="list-style-type: none"> ● Does the statement contain the terms that the person is willing to be contractually bound? → Yes. ● Are the terms of the offer definitive? → Yes. ● How was the offer addressed/made? → Directed to the offeree. ● Is the offer still in existence? → Yes. ● Stephanie’s offer to purchase Café Express meets the legal requirements of an offer.
<ul style="list-style-type: none"> ● On Wednesday afternoon, John contacts James and informs him that an anonymous investor has provided a written offer to purchase Café Express for \$400,000. 	<ul style="list-style-type: none"> ● Does the statement contain the terms that the person is willing to be contractually bound? → Yes. ● Are the terms of the offer definitive? → Yes. ● How was the offer addressed/made? → Directed to the offeree.

Applying the law to the facts of the example question	
	<ul style="list-style-type: none"> Is the offer still in existence? → Yes. The anonymous investor's offer to purchase Café Express meets the legal requirements of an offer.
Acceptance: Which offer was accepted?	
Relevant facts of the example question	Application of the law to the facts of the example question
<ul style="list-style-type: none"> On Wednesday morning, James emails Stephanie telling her that he is willing to sell his business, Café Express, for \$300,000 to her. 	<ul style="list-style-type: none"> Was the offer addressed to the person seeking to accept it? → Yes. Was the statement an unconditional assent to the terms of the offer? → Yes. Has the offeree communicated acceptance? → Yes, by email. Provided the email was registered by Stephanie's specified information system, ie Stephanie's email account, the acceptance will be deemed to have been communicated. Therefore, James's email meets the legal requirements of an acceptance

Reach a conclusion	
Agreement: Has an agreement been reached?	
Relevant facts of the example question	Application of the law to the facts of the example question
<ul style="list-style-type: none"> James immediately calls Stephanie and tells her to ignore the email he had sent her earlier that day. Stephanie is very angry and believes that they have formed a legally binding contract. 	<ul style="list-style-type: none"> On the balance of probabilities, an agreement was formed between Stephanie and James. Stephanie offered to purchase Café Express for \$300,000 and James accepted by email. Once James's acceptance email was registered in Stephanie's email information system, an agreement was formed between the parties. Therefore, James's attempt to withdraw the acceptance email constitutes a breach of contract.

¶1-130 Answer structure — Question 3

Q3: In the given circumstances, does James or Stephanie have to provide consideration? If so, on the facts, has either party provided consideration?

*Hint: The question asks you to only consider whether the agreement between James and Stephanie requires the provision of **consideration** and, if so, has either party provided the requisite consideration. Therefore, there is no need to discuss the other elements of contract formation, ie agreement and intention to form a legally binding agreement.*

Principles of law — checklist
Consideration
<ul style="list-style-type: none"> Was the contract executed in a deed? If not, then consideration is required. Define "consideration".

Principles of law — checklist
<ul style="list-style-type: none"> ● What type of consideration is each party providing? <ul style="list-style-type: none"> ■ executed consideration? (<i>Carlill v Carbolic Smoke Ball Co</i> [1893] 1 QB 256) ■ executory consideration? (<i>Musumeci v Winadell Pty Ltd</i> (1994) 34 NSWLR 723), or ■ past consideration? (<i>Roscorla v Thomas</i> (1842) 3 QB 234). ● Does the consideration from both parties have legal value? (<i>Eleanor Thomas v Benjamin Thomas</i> (1842) 2 QB 851).

Applying the law to the facts of the example question	
Consideration	
Relevant facts of the example question	Application of the law to the facts of the example question
<ul style="list-style-type: none"> ● Stephanie offers to purchase Café Express for \$300,000. 	<ul style="list-style-type: none"> ● Was the contract executed in a deed? → No, therefore consideration is required. ● What type of consideration was provided? → Stephanie provided executory consideration in the form of the promise to provide \$300,000. ● Does the consideration provided have legal value? → Yes.
<ul style="list-style-type: none"> ● On Wednesday morning, James emails Stephanie telling her that he is willing to sell his business, Café Express, for \$300,000 to her. 	<ul style="list-style-type: none"> ● Was the contract executed in a deed? → No, therefore consideration is required. ● What type of consideration was provided? → James provided executory consideration in the form of the promise to provide the title of ownership to Café Express. ● Does the consideration provided have legal value? → Yes.

Reach a conclusion
<p>Consideration: Is consideration required in the given circumstance and, if so, has sufficient consideration been provided?</p>
<p>Given that the contract between James and Stephanie was not executed in a deed, consideration is required from both parties. It appears that both parties have provided sufficient consideration:</p> <ul style="list-style-type: none"> ● James’s consideration is the promise to hand over the title of ownership to Café Express to Stephanie, and ● Stephanie’s consideration is the promise to give James \$300,000.

¶1-135 Answer structure — Question 4

Q4: Have James and Stephanie formed a legally enforceable contract?

Hint: If the question asks you to discuss whether a “legally enforceable contract” has been formed, you need to consider all three elements discussed above. That is, whether there is an agreement, intention to create a legally binding agreement and consideration (provided the contract is not executed in deed).

Note: The following table is an abridged combination of the above three tables.

Principles of law — checklist
Legally enforceable contract
<ul style="list-style-type: none"> Define “legally enforceable contract”, ie what is a legally enforceable contract comprised of?
Agreement
<ul style="list-style-type: none"> Define “agreement”.
Offer
<ul style="list-style-type: none"> Define “offer”.
<ul style="list-style-type: none"> Does the statement contain the terms that the offeror is willing to be contractually bound? (<i>Harvey v Facey</i> [1893] AC 552).
<ul style="list-style-type: none"> Are the terms of the offer definitive? If no, is the statement any of the following? <ul style="list-style-type: none"> puffs? advertisements? (<i>Partridge v Crittenden</i> [1968] 2 All ER 421) goods displayed on shelves? (<i>Pharmaceutical Society v Boots Cash Chemist (Southern) Ltd</i> [1953] 1 QB 401) tenders?, or auctions? (<i>Harris v Nickerson</i> (1873) LR 8 QB 286).
<ul style="list-style-type: none"> How was the offer addressed/made? <ul style="list-style-type: none"> Was it directed to the offeree? Was it directed to a particular class of people (of which the offeree belonged to)? (<i>R v Clarke</i> (1927) 40 CLR 227) Was it directed to the world at large? (<i>Carlill v Carbolic Smoke Ball Co</i> [1893] 1 QB 256).
<ul style="list-style-type: none"> Is the offer still in existence? <ul style="list-style-type: none"> Has the offer been withdrawn prior to the offeree accepting the offer? (<i>Routledge v Grant</i> (1828) 130 ER 920) Has a reasonable period of time passed causing the offer to have lapsed? (<i>Ramsgate Hotel Co v Montefiore</i> (1866) LR 1 Exch 109) Has the offer lapsed by virtue of a counter-offer? (<i>Hyde v Wrench</i> [1840] 49 ER 132).
Acceptance
<ul style="list-style-type: none"> Define “acceptance”.
<ul style="list-style-type: none"> Was the offer addressed to the person seeking to accept it?
<ul style="list-style-type: none"> Was the statement an unconditional assent to the terms of the offer? If no, is the statement any of the following: <ul style="list-style-type: none"> acceptance subject to a condition? (eg “subject to contract” term (<i>Masters v Cameron</i> (1954) 91 CLR 353)), or counter-offer? (<i>Hyde v Wrench</i> [1840] 49 ER 132).
<ul style="list-style-type: none"> Has the offeree communicated acceptance? If yes, which method did the offeree employ? (NB: This will effect when and where the agreement formed.): <ul style="list-style-type: none"> verbal? conduct? (<i>Carlill v Carbolic Smoke Ball Co</i> [1893] 1 QB 256) post? (<i>Henthorn v Fraser</i> [1892] 2 Ch 27) email? (see, for example, the <i>Electronic Transactions (Victoria) Act 2000</i>), or fax? (<i>Brinkibon Ltd v Stahag Stahl und Stahlwarenhandelsgesellschaft mbH</i> [1983] 2 AC 34).
Intention to form a legally binding agreement
<ul style="list-style-type: none"> Define “intention to form a legally binding agreement”.
<ul style="list-style-type: none"> How do the courts determine whether a party intends to form a legally binding agreement?

Principles of law — checklist	
<ul style="list-style-type: none"> What presumptions do the courts apply in determining whether a party intends to form a legally binding agreement? <ul style="list-style-type: none"> Are the parties of a domestic or social relationship? (<i>Balfour v Balfour</i> [1919] 2 KB 571) Are the parties of a commercial or business relationship? (<i>Esso Petroleum Ltd v Commissioners of Customs & Excise</i> [1976] 1 All ER 117). 	
<ul style="list-style-type: none"> Are the presumptions rebuttable? <ul style="list-style-type: none"> Can a party demonstrate that, despite the parties' domestic or social relationship, the parties did intend to be legally bound to the agreement? (<i>Merritt v Merritt</i> [1970] 2 All ER 760 and <i>Commonwealth Bank of Australia v TLI Management Pty Ltd</i> [1990] VR 510). 	
Consideration	
<ul style="list-style-type: none"> Was the contract executed in a deed? If not, then consideration is required. 	
<ul style="list-style-type: none"> Define "consideration". 	
<ul style="list-style-type: none"> What type of consideration is each party providing? <ul style="list-style-type: none"> executed consideration? (<i>Carlill v Carbolic Smoke Ball Co</i> [1893] 1 QB 256) executory consideration? (<i>Musumeci v Winadell Pty Ltd</i> (1994) 34 NSWLR 723), or past consideration? (<i>Roscorla v Thomas</i> (1842) 3 QB 234). 	
<ul style="list-style-type: none"> Does the consideration from both parties have legal value? (<i>Eleanor Thomas v Benjamin Thomas</i> (1842) 2 QB 851). 	

Applying the law to the facts of the example question	
Legally enforceable contract	
<ul style="list-style-type: none"> To determine whether a legally enforceable contract was reached between James and Stephanie, the legal aspects of agreement, intention to form a legally binding agreement and consideration must be considered. 	
Agreement	
<ul style="list-style-type: none"> To determine whether an agreement was reached between James and Stephanie, the legal aspects of offer and acceptance must be considered. 	
Offer: Who made the offer?	
Relevant facts of the example question	Application of the law to the facts of the example question
<ul style="list-style-type: none"> Williams and Associates placed an advertisement in the local newspaper advertising Café Express for sale. 	<ul style="list-style-type: none"> Does the statement contain the terms that the person is willing to be contractually bound? → Yes. Are the terms of the offer definitive? → No, the statement was an advertisement. How was the offer addressed/made? → Directed to a particular class of people. Is the offer still in existence? → Yes. The advertisement placed by Williams and Associates was not an offer because it did not satisfy the legal requirements of an offer as the terms of the offer were not definitive.

Applying the law to the facts of the example question	
<ul style="list-style-type: none"> Stephanie offers to purchase Café Express for \$300,000. Stephanie tells James to think about her offer and to get back to her at the end of the week, but no later than the coming Friday at 5 pm. 	<ul style="list-style-type: none"> Does the statement contain the terms that the person is willing to be contractually bound? → Yes. Are the terms of the offer definitive? → Yes. How was the offer addressed/made? → Directed to the offeree. Is the offer still in existence? → Yes. Stephanie's offer to purchase Café Express meets the legal requirements of an offer.
<ul style="list-style-type: none"> On Wednesday afternoon, John contacts James and informs him that an anonymous investor has provided a written offer to purchase Café Express for \$400,000. 	<ul style="list-style-type: none"> Does the statement contain the terms that the person is willing to be contractually bound? → Yes. Are the terms of the offer definitive? → Yes. How was the offer addressed/made? → Directed to the offeree. Is the offer still in existence? → Yes. The anonymous investor's offer to purchase Café Express meets the legal requirements of an offer.
Acceptance: Which offer was accepted?	
<i>Relevant facts of the example question</i>	<i>Application of the law to the facts of the example question</i>
<ul style="list-style-type: none"> On Wednesday morning, James emails Stephanie telling her that he is willing to sell his business, Café Express, for \$300,000 to her. 	<ul style="list-style-type: none"> Was the offer addressed to the person seeking to accept it? → Yes. Was the statement an unconditional assent to the terms of the offer? → Yes. Has the offeree communicated acceptance? → Yes, by email. Therefore, James's email meets the legal requirements of an acceptance.
Intention to form a legally binding agreement	
<i>Relevant facts of the example question</i>	<i>Application of the law to the facts of the example question</i>
<ul style="list-style-type: none"> Stephanie is a close family friend of James. 	<ul style="list-style-type: none"> Applying the presumptions that the courts rely on to determine whether the parties intended to form a legally binding agreement: <ul style="list-style-type: none"> Are the parties of a domestic or social relationship? → Yes, James and Stephanie are close family friends. Are the parties of a commercial or business relationship? → No, but James and Stephanie appear to have entered into a commercial or business agreement. The agreement was for the sale of a business in exchange for \$300,000.

Applying the law to the facts of the example question	
	<ul style="list-style-type: none"> Given that James and Stephanie have a social relationship, it is presumed that James and Stephanie did not possess the intention to a legally binding agreement. However, it appears that the parties have entered into a commercial agreement as the agreement was for the sale and purchase of a business in exchanged for a substantial amount of money, ie \$300,000. In the given circumstances, it is arguable that the presumption regarding parties of a social relationship is rebuttable as the parties did possess the intention to form a legally binding agreement.
<ul style="list-style-type: none"> Stephanie knows how much James wants to leave the hospitality industry. 	<ul style="list-style-type: none"> Is there evidence on the facts to suggest the presumption is rebuttable? → The fact that Stephanie is aware that James wants to leave the hospitality industry is not an indication of the closeness of their relationship. The advertisement placed by Williams and Associates advertising the sale of Café Express is an indication to the world at large of James's desire to leave the hospitality industry.
<ul style="list-style-type: none"> Stephanie offers to purchase Café Express for \$300,000, which is \$50,000 below James's minimum asking price. 	<ul style="list-style-type: none"> Is there evidence on the facts to suggest the presumption is rebuttable? → The fact that Stephanie offers to purchase Café Express for \$50,000 below the minimum asking price to which James accepts is not an indication of the closeness of their relationship. It is very common business practice to barter and make offers below the minimum asking price. Also, the offer to purchase Café Express for \$300,000 is a competitive commercial rate for a business.
<ul style="list-style-type: none"> James does not consult with Williams and Associates regarding Stephanie's offer. 	<ul style="list-style-type: none"> Is there evidence on the facts to suggest the presumption is rebuttable? → The fact that James did not consult Williams and Associates regarding Stephanie's offer is not common commercial practice. Although this fact does not assist in rebutting the presumption, it does not support the presumption either.
Consideration	
<i>Relevant facts of the example question</i>	<i>Application of the law to the facts of the example question</i>
<ul style="list-style-type: none"> Stephanie offers to purchase Café Express for \$300,000. 	<ul style="list-style-type: none"> Was the contract executed in a deed? → No, therefore consideration is required. What type of consideration was provided? → Stephanie provided executory consideration in the form of the promise to provide \$300,000. Does the consideration provided have legal value? → Yes.

Applying the law to the facts of the example question

- | | |
|---|--|
| <ul style="list-style-type: none"> ● On Wednesday morning, James emails Stephanie telling her that he is willing to sell his business, Café Express, for \$300,000 to her. | <ul style="list-style-type: none"> ● Was the contract executed in a deed? → No, therefore consideration is required. ● What type of consideration was provided? → James provided executory consideration in the form of the promise to provide the title of ownership to Café Express. ● Does the consideration provided have legal value? → Yes. |
|---|--|

Reach a conclusion

Legally enforceable contract: Have James and Stephanie formed a legally enforceable contract?

On the balance of probabilities, it appears that James and Stephanie have formed a legally enforceable contract. Based on the facts provided, it appears that James and Stephanie:

- formed an agreement (Stephanie offered to purchase James's business, to which James accepted)
- intended to be legally bound to the agreement, and
- provided sufficient consideration (as the contract was not executed in deed).

CONTENTS OF A CONTRACT

¶1-205 Snapshot of the law

The contents of the contract specify what the parties are required to do to discharge their contractual obligations. The contents of a contract are commonly referred to as “terms”.

Generally, in a commercial context, contracts are executed in written documentation. Where a contract is reduced to writing, the contents of the contract are contained in the written documentation. When parties to a contract have signed a contractual document, the courts will presume that the parties have read, understood and agreed to the terms contained in the contract (*L'Estrange v F Graucob Ltd* [1934] 2 KB 394).

Although commercial contracts are commonly entered into through formal means, contracts can also be entered into informally (eg through verbal negotiations or oral and written exchanges).

In circumstances where a dispute arises between the parties as to what was agreed, the courts must determine objectively what the parties intended to incorporate into the contract. The courts must ascertain the parties' intention from their words, conduct and the nature of the contractual agreement.

Where a contract is reduced to writing, the courts presume that the written contract contains all the agreed terms. Generally, the courts will not permit the introduction of extrinsic evidence to vary the terms contained in the written contract (*British Movietonews Ltd v London and District Cinemas* [1952] AC 166). This legal principle is referred to as the parol evidence rule. However, there are exceptions to the parol evidence rule. Extrinsic materials may be permitted to demonstrate additional terms in the following circumstances:

- there are collateral contracts (*Van Den Esschert v Chappell* [1960] WAR 114), or
- to rectify a mistake or ambiguity.

Statements that are not contractually binding

Not everything that is said during contract negotiations is contractually binding. The following types of statements are not considered to form part of the contract:

- puffery
- opinions, and
- representations.

Although representations are not contractually enforceable, representations that prove to be untrue (ie misrepresentations) may be legally actionable under tort law or the Australian Consumer Law.

Terms of a contract

Terms can be incorporated into a contract in one of two ways:

1. express terms, or
2. implied terms.

“Express terms” are the terms that were actually specified by the parties, either verbally or in writing. Disputes may arise between the parties as to what was agreed prior to the contract being reduced to writing. In such circumstances, the courts must determine whether the statement made during negotiations was puffery, an opinion, a representation or a term. Factors that the courts may take into consideration when determining the parties’ intention are:

- the time the statement was made prior to the parties entering into the contract
- the importance of the statement
- whether the person making the statement had special or expertise knowledge or skill, and
- whether the statement was promissory in nature

(*Oscar Chess Ltd v Williams* [1957] 1 All ER 325 and *Handbury v Nolan* (1977) 13 ALR 339).

“Implied terms” are the terms that are implied into a contract by the courts. The courts will only imply a term into a contract if it is believed (based on the facts presented) that the parties intended for such a term to be incorporated. For a term to be implied by the courts, the implied term must:

- be reasonable and equitable
- be capable of clear expression
- provide business efficacy to the contract
- be so obvious that it “goes without saying”, and
- not contradict any express terms

(*BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 180 CLR 266).

There are a number of terms that are implied into all contracts by virtue of the common law. For instance, there is an implied term that all parties to the contract must act in good faith (*Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 151).

Terms may also be implied into a contract by virtue of legislation. For instance, the Australian Consumer Law, which is part of the *Competition and Consumer Act 2010* (Cth), implies a number of consumer guarantees into consumer contracts.

Exclusion clauses

An exclusion clause is a term of the contract that excludes or limits legal liability of a party to the other party or parties. Provided that the exclusion clause was incorporated into the contract according to the legal principles of contract law, the courts will treat the exclusion clause like any other term within the contract. However, in the event of ambiguity, the courts will interpret the exclusion clause against the party seeking to rely on it (*Sydney Corporation v West* (1965) 114 CLR 481).

Classification of the terms

The courts classify terms according to their level of importance. This classification will determine the remedies available in the event that a party does not discharge his or her obligations under the contract. Terms are classified as follows:

- *Condition*: This is an essential term of the contract that goes to the root and heart of the contract (ie a term that reflects the purpose of the contract) (*Associated Newspaper Ltd v Bancks* (1951) 83 CLR 322).
- *Warranty*: This is a non-essential term of the contract (ie a term that supplements the purpose of the contract) (*Bettini v Gye* (1876) 1 QBD 183).
- *Intermediate term*: This is a term that falls between a condition and a warranty (*Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26).

A breach of a condition will entitle the aggrieved party to either terminate the contract and sue for damages, or keep the contract on foot and sue for damages. A breach of warranty only entitles the aggrieved party to sue for damages. Therefore, in circumstances where there has only been a breach of warranty, the aggrieved party must continue with the contract.

In circumstances where an intermediate term has been breached, the court will assess the significance of the breach and determine which remedy is most appropriate in the given circumstances. Therefore, an intermediate term will be classified as either a condition or a warranty according to the consequences that arise as a result of the breach.

¶1-210 Question example

Monica Corales owns and operates a childcare business in Melbourne called Childcare Express. The childcare facility is situated on a main road that experiences high levels of traffic congestion. Although the location of the childcare facility is great for business exposure, Monica is always concerned about the safety of the children when they are playing outside. To increase safety measures, Monica decides to erect a new fence around the premises of Childcare Express.

Monica contacts Lucas Constructions and speaks to the construction manager, Nikko Lucas. She informs him that she would like a new picket fence to be built around the premises of Childcare Express. She also emphasises that the fence must be of the highest quality and, most importantly, childproof. Nikko assures Monica that she contacted the right construction

company, as Lucas Constructions is the best construction company in Melbourne! He also mentions that Lucas Constructions is the only construction company in Melbourne that offers a lifetime warranty for the craftsmanship of the construction work. Pleased with what she hears, Monica immediately agrees to use the services of Lucas Constructions.

To finalise the agreement, Nikko sends Monica a standard contract. The form requires Monica to indicate the height, material and colour of the fence she wants. She elects to have a 1.5 metre timber white fence to be built around the childcare premises, which are situated on a 950 square metre block. The contract specifies that Monica must pay for the cost of the materials and \$100 per hour for 15 hours worth of labour. The contract also contains a term outlining the maximum expenditure permitted (contractual terms of this nature are quite common in construction contracts). The term specifies that the total cost of constructing the fence would not exceed \$5,000.

Monica signs the contract after specifying the fence dimensions and glancing at the construction cost. She does not bother to read the remaining portion of the standard contract and does not notice the following terms:

"Lucas Constructions assures that during the period of warranty, the construction work will be free of defects in materials and craftsmanship (provided the construction work is subjected to normal and ordinary use).

Lucas Constructions is not liable for any damage to the premises where the construction work is being carried out however caused."

Monica returns the contract to Lucas Constructions. Nikko signs the contract on behalf of Lucas Constructions.

¶1-215 Common questions assessed in this area of law

A question concerning contents of a contract will generally ask you one (or a combination) of the following questions:

1. What were the express terms of the contract between Monica and Lucas Constructions?
2. Suppose that after Monica and Lucas Constructions finalise the contract, the demand for timber rises exponentially causing the price of timber to increase substantially worldwide. Lucas Constructions is of the opinion that Monica should bear the cost associated with the increased price of timber, irrespective of the term outlining the maximum expenditure permitted, ie the total cost of constructing the fence would not exceed \$5,000. Lucas Constructions claims that such a term is implied in the contract. Is Lucas Constructions correct?
3. Identify the express terms of the contract and state whether these are conditions, warranties or intermediate terms.

¶1-220 Answer structure — Question 1

Q1: What were the express terms of the contract between Monica and Lucas Constructions?

Hint: The question asks you to consider only the express terms of the contract. To determine what the express terms of the contract were, you need to analyse all the statements expressly made by the parties, ie the statements that were made either verbally or in writing.

Principles of law — checklist

Express terms

- Define “express terms”.
- How do the courts determine which statements form part of the contract? What factors do the courts rely on?
- Did the parties intend for the statement to form part of the contract? If no, was the statement any of the following:
 - puffery?
 - opinion?, or
 - representation?
 (*Oscar Chess Ltd v Williams* [1957] 1 All ER 325 and *Handbury v Nolan* (1977) 13 ALR 339).
- Define the “parol evidence rule” (*British Movietonews Ltd v London and District Cinemas* [1952] AC 166).
- Are there any exceptions to the parol evidence rule? (*Van Den Esschert v Chappell* [1960] WAR 114).
- Define the “exclusion clause”.
- How do the courts interpret exclusion clauses? (*Sydney Corporation v West* (1965) 114 CLR 481).
- What is the effect of a party having signed a contractual document? (*L'Estrange v F Graucob Ltd* [1934] 2 KB 394).

Applying the law to the facts of the example question

Express terms

Relevant facts of the example question

- Monica informs Nikko that she would like a new picket fence to be built around the premises of Childcare Express.
- She also emphasises that the fence must be of the utmost highest quality and most importantly, childproof.

Application of the law to the facts of the example question

- When was the statement made? → Monica verbally made this statement prior to the parties entering into the contract.
- Was the statement contained in the written contract? → Yes, the statement was contained in the written contract.
- Therefore, the statement is a term of the contract.
- When was the statement made? → Monica verbally made this statement prior to the parties entering into the contract.
- Was the statement contained in the written contract? → No, it does not appear that this statement was contained in the written contract.
- This statement appears to be a mere expression of a description of what Monica was seeking.
- Therefore, the statement is unlikely to be considered an express term of the contract, despite the emphasis of importance suggested by Monica. The facts do not suggest that Monica was enticed to enter the contract on the basis of the assurance given by Nikko.

Applying the law to the facts of the example question

<ul style="list-style-type: none"> Nikko assures Monica that she contacted the right construction company, as Lucas Constructions is the best construction company in Melbourne! 	<ul style="list-style-type: none"> When was the statement made? → Nikko verbally made this statement to Monica prior to the parties entering into the contract. Was the statement contained in the written contract? → No, it does not appear that this statement was contained in the written contract. This statement was not promissory in nature. It was an exaggerated statement that no reasonable person would assume to be true. Therefore, the statement is unlikely to be considered an express term of the contract. It is likely to be categorised as puffery.
<ul style="list-style-type: none"> Prior to entering into the contract, Nikko mentions that Lucas Constructions is the only construction company in Melbourne that offers a lifetime warranty for the craftsmanship of the construction work. 	<ul style="list-style-type: none"> When was the statement made? → Nikko verbally made this statement prior to the parties entering into the contract. Upon hearing this statement, Monica agrees to use the services of Lucas Constructions and does sign the contract soon after. It appears that this statement was important to Monica as she decided to enter into the contract based on this statement. Was the statement contained in the written contract? → No, this statement was not contained in the written contract. Applying the parole evidence rule: extrinsic evidence may be admissible to prove this statement was made and was, in fact, a collateral contract to the written agreement itself. Based on the facts provided, it appears that Monica relied on this assurance made by Nikko when entering into the contract. The facts also suggest that Monica entered into the contract based on this assurance, as she signs the contract almost immediately after the assurance was made.
<ul style="list-style-type: none"> Monica specifies in the contract that the fence is to be: <ul style="list-style-type: none"> 1.5 metres in height made of timber white in colour, and constructed around the Childcare Express premises (a 950 square metre block). 	<ul style="list-style-type: none"> Were the statements contained in the written contract? → Yes, these statements were contained in the written contract. Therefore, these statements are terms of the contract.

Part 1:
Contract Law

Applying the law to the facts of the example question

<ul style="list-style-type: none"> ● Monica must pay for the cost of the materials and \$100 per hour for 15 hours worth of labour. However, the total cost of constructing the fence would not exceed \$5,000 (ie the term outlining the maximum expenditure permitted). 	<ul style="list-style-type: none"> ● Was the statement contained in the written contract? → Yes, this statement was contained in the written contract. ● Therefore, this statement is a term of the contract.
<ul style="list-style-type: none"> ● Lucas Constructions assures that, during the period of warranty, the construction work will be free of defects in materials and craftsmanship (provided the construction work is subjected to normal and ordinary use). ● Lucas Constructions is not liable for any damage to the premises where the construction work is being carried out however caused. 	<ul style="list-style-type: none"> ● Was the statement contained in the written contract? → Yes, this statement was contained in the written contract. ● Therefore, this statement is a term of the contract. ● Was the statement contained in the written contract? → Yes, this statement was contained in the written contract. ● Therefore, this statement is a term of the contract. ● This term is an exclusion clause. Although it is legally enforceable, it must be noted that the courts interpret exclusion clauses very strictly. In cases of ambiguity, the courts will interpret the exclusion clause against the party seeking to rely on it (ie Lucas Constructions).
<ul style="list-style-type: none"> ● Monica signs the contract and Nikko signs the contract on behalf of Lucas Constructions. 	<ul style="list-style-type: none"> ● Given that both parties have signed the contract, the courts will assume that the parties have read, understood and agreed to be bound by all of the terms contained in the contract. ● Although Monica did not read the contract in its entirety, she will nevertheless be bound to the terms of the contract.

Reach a conclusion

Express terms: What were the express terms of the contract between Monica and Lucas Constructions?

The express terms of the contract between Monica and Lucas Constructions were:

- Lucas Constructions would construct and erect a fence around the Childcare Express premises (a 950 square metre block).
- The specifications of the fence were:
 - 1.5 metres in height
 - made of timber, and
 - white in colour.
- Monica must pay for the cost of the materials and \$100 per hour for 15 hours' worth of labour. However, the total cost of constructing the fence would not exceed \$5,000 (ie the term outlining the maximum expenditure permitted).



Reach a conclusion

- The term, with respect to the period of warranty, will depend on whether the courts find that the statement made during the contractual negotiations, ie the lifetime warranty for the craftsmanship of the construction work, was a collateral contract to the written contract. In the given circumstances, it is probable that the courts will find that the statement regarding the lifetime warranty would be an express term of the contract, forming a collateral contract to the written contract, as Monica relied on the assurance when entering into the contract.
- Lucas Constructions is not liable for any damage to the premises where the construction work is being carried out however caused.

Part 1:
Contract Law