Formation of Contract at Common Law

(From an Australian Law Perspective)
Elements of Formation of Contract

• Two main elements:
  1) Agreement
     a) Offer
     b) Acceptance
  2) Consideration

• Other elements:
  1) Intention to create legal relations
  2) Capacity
  3) Formalities
Agreement – Offer

• **Definition** – Statement by one person to another person, evincing his/her willingness to enter into contractual relations with that person on certain terms.
  - Distinguish offer from an “Invitation to Treat” – E.g. auctions, tenders – Test of intention: Did the party making the statement intend that an affirmative response would give rise to an agreement or simply result in further negotiation? If YES, then you have a legal offer. If NO, then there is no offer which may be accepted which subsequently gives rise to legal obligations.

• **Scope** – An single offer may be made to a distinct person or people, or the world at large (*Carbolic Smoke Ball case*).

• **Central requirement** – The statement alleged to be an offer must indicate a willingness to be bound without further negotiations as to the terms of the proposed contract.

• **Termination** – 1) Revocation; 2) Rejection; 3) Lapse of time; 4) Death of the offeree; and 5) Failure of condition precedent.
Agreement – Acceptance

• **Definition** – Unequivocal statement (oral, written or by conduct) by the offeree agreeing to the offeror’s offer.

• **Requirements:**
  1) Must exactly correspond with the offer (otherwise will be deemed a counter-offer).
  2) Must be unequivocal (hence an offeree must have knowledge of an offer before accepting it).
  3) Must be communicated by the offeree to the offeror (onus of communication is on the offeree). An agreement is concluded upon the communication being received by the offeror.
    - Note that there are several exceptions to the requirement of communication which may apply. E.g. waiver by offeror.
Consideration

• **Definition** under the “Bargain Theory of Consideration” (Adopted in Australia by *Australian Woolen Mills case*) – An act/forbearance of the one party on the promise thereof is the price for which the promise is bought.

• **Requirements:**
  1) Must be a connection between the consideration and the promise which it is said to support.
  2) Must move from the promisee, but not necessarily to the promisor (*Coulls v Bagot’s Executor and Trustee*).
  3) Must be sufficient but need not be adequate (*Chappell & Co v Nestle & Co Ltd*) – Illegal consideration is not sufficient, and excessively inadequate consideration may not be sufficient.
  4) Past consideration is not good consideration (*Lampleigh v Brathwait*).
Consideration continued...

• **Exceptions to the requirement** of consideration:
  1) Promises under seal (deeds).
  2) Doctrine of Promissory estoppel – Where it would be inequitable for the promisor not to be held to the promise.

• **Rationale for the requirement** of consideration?:
  1) Evidentiary and cautionary function – Corroborates the seriousness of intent to be bound.
  2) Maintains equity/fairness – Contracts ought to be of *quid pro quo* nature.
  3) Identifies the measure of relief in circumstances of breach.
  4) Distinguishes equitable remedies applicable in circumstances of contract and circumstances of gift – Different equitable remedies become available.
Intention to create legal relations

- **Concept** – For a contract to exist the parties to an agreement must intend to create legal relations.

- **Role of consideration** – Consideration is often evidence of intention.

- **Presumptions of intent** – Certain relationships between persons carry with them a rebuttable presumption. E.g. familial relationships are presumed not to give rise to an intention to create legal relations, while the opposite is true for commercial relations.
Capacity

- **Concept** – For a contract to exist the parties must have contractual capacity. There are certain persons and classes of persons that lack the capacity to enter into a contract with the consequence (normally) that resulting contracts will not be enforceable against them.
- **Rationale?** – Protection of persons who may be vulnerable to exploitation.
- **Classes of persons:**
  1) Mental disorder or intoxication – A contract is voidable at the option of a party who, as a result of mental disorder or intoxication, is unable to understand the nature of the contract being made (provided that the other party knew, or ought to have known, of that person’s disability).
  2) Bankrupts – A bankrupt person may make a contract but unprofitable contracts made prior to bankruptcy may be disclaimed by the trustee.
  3) The Crown – At common law proceedings could not be taken against the Crown, but legislation has removed this immunity in most cases.
  4) Minors – Generally, both the common law and statute restrict the capacity of minors to enter into contracts.
  5) Companies – At common law, a company only has capacity to enter into contracts permitted by its constitution.
Formalities

• **Concept** – As a general rule contracts do not need to comply with any sort of formalities. However, nowadays many categories of contract are governed by statute.

• **Contracts for sale of land** – Must be in writing, otherwise are unenforceable.

• **Effect of non-compliance** – Renders a contract unenforceable.

• **Doctrines of part-performance** – This doctrine provides that where the plaintiff has partly carried out the contract, relying on the defendant’s promise, equity may enforce the contract despite non-compliance with formalities.
  
  o **Rationale** – Formalities requirements are generally designed to prevent fraud, but strict adherence to such requirements might themselves facilitate fraud by enabling those who entered into such contracts to deny the existence of the contract or otherwise seek to avoid their promised obligations by relying on non-compliance as a defence to a contractual claim.