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# Contract Law

SECOND EDITION

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**TICKET BOOTH**

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it an excellent student text.'*

Paula Giliker, University of Bristol

# Contract Law

## **Part II**

# The birth of the contract

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# A. Formation of a contract: the positive requirements

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### Agreement: offer and acceptance

#### Introduction

A 'contract' consists of: agreement, an intention to create legal relations and supporting consideration.<sup>1</sup> The first and second elements are clear. Agreement states the law's insistence upon a corresponding offer and acceptance; the requirement of contractual intention means that purely social and domestic arrangements are not usually enforceable in the courts. The third element, consideration, needs further explanation.<sup>2</sup> At its most basic, consideration is the price paid for a promise, i.e. whatever is given in 'consideration' of it. This consideration may itself be another promise, in which case the contract is called a 'bilateral' one, e.g. a house purchase where one party promises to pay a sum of money in exchange for a counter promise to convey property, or it may consist in the performance of an act, e.g. the promise to pay a reward for the return of lost property, in which case the contract is described as 'unilateral'. Unilateral and bilateral contracts may, subject to few exceptions, be either written or oral. The most important exception is a contract for the sale of an interest in land which is required to be in writing.<sup>3</sup> This book is concerned solely with simple contracts which, for the sake of brevity, we will henceforth simply describe as contracts. The phenomenon of agreement will be the subject of this chapter; the requirements of consideration and contractual intention will be examined in succeeding chapters.

In contrast to a 'simple contract', a deed must be written and needs no consideration. It provides a mechanism by which gratuitous promises (i.e. these not made in return for anything) can be made binding. Therefore, deeds have more in common with the law of gift than the law of contract, the latter being based upon mutual exchange, i.e. upon 'bargain'. Deeds tend also to be used in connection with more formal dealings, the purchase of land, building and engineering contracts. Although a deed is not a requirement of such contracts,<sup>4</sup> the use of a deed offers an important advantage. The time within which

<sup>1</sup> An agreement supported by consideration and an intention to create legal relations is sometimes called a 'simple' contract to distinguish it from a promise contained in a deed which does not require consideration.

<sup>2</sup> See further Chapter 4.

<sup>3</sup> Law of Property (Miscellaneous Provisions) Act 1989, s 2. See below for an examination of the other formal requirements.

<sup>4</sup> As they are, for example, in respect of the creation of a lease for more than three years; see Law of Property Act 1925, ss 52, 54(2).

an action for breach of any obligation assumed must be brought, the so called 'limitation period', is longer when that obligation is contained in a deed. In the case of deeds, the limitation period is 12 years;<sup>5</sup> for simple contracts it is generally six years;<sup>6</sup> and only three years if damages are claimed in respect of personal injury suffered as a result of negligence, nuisance or breach of duty.<sup>7</sup> This longer limitation period is especially attractive in such contracts when a breach of contract may not manifest itself for a number of years.

A number of important points emerge from this general discussion which bear repetition. First, the law of contract is concerned with the enforcement of bargains and not with gifts. Another is that there is a divergence between the lawyers' vocabulary and common usage of the word contract. To the lawyer a contract is a bundle of legal obligations created by agreement, contractual intention and consideration. However, many people use the word contract to refer to a written document. In other words, the common usage seems to rest upon confusion between the form and substance of legal obligation. This may explain why people are not immediately aware how often in their daily lives they enter contracts; it is not only when they start a new job or rent a house but also each time they buy a cup of coffee or catch a bus.

As you consider the cases which follow, try to think about two related questions which we will take up during the course of the chapter. First, how well does the law of offer and acceptance deal with the great diversity of factual situations, which fall within its ambit? These range from complex, high-value transactions between nationals of different countries, e.g. international sales contracts to low-value consumer contracts, such as buying a train ticket or putting money into a ticket machine in a car park. Second, how do the courts arrive at a resolution of the dispute they are called upon to adjudicate? Is it by the application of clear rules or do they reach an instinctive justice, aided by little more than an intuitive but unarticulated sense of fairness concealed by a smokescreen of rule, sub-rule and exception so malleable that it could be moulded to support any conclusion? As it is sometimes put, do the courts reason *to* a conclusion or *from* one?

## Whose agreement?

When discussing the topic of agreement it is convenient to speak as if the parties were themselves in no doubt as to what agreement had been reached and the only disputed issue is what legal effect, if any, should be given to that agreement. However, in some cases the parties will each assert different understandings of what was agreed. It is important to realise at the outset that usually contractual intention is ascertained *objectively not* subjectively. An example will help illustrate this.

While typing on a new iPad, I ask you whether you would like to buy 'my computer' for £1k. You agree. Thereupon, I pull out of my bag an old laptop worth £50 and demand my £1k.

<sup>5</sup> Limitation Act 1980, s 8(1).

<sup>6</sup> Limitation Act 1980, s 5.

<sup>7</sup> Whether the injury arises out of a breach of contract or not: Limitation Act 1980, s 11. However, this period may be extended under s 33.

If on the above facts you had obliged yourself to pay £1k for the old laptop, the law would indeed, as Henry Ford famously said, be an ‘ass’. Fortunately you have not, and it, usually, is not. The contractual offer I am considered to be making is not one which I secretly, subjectively, intend but the one that a reasonable onlooker would think I was making, i.e. to sell the computer I was working on when I spoke. In a famous statement Blackburn J said:<sup>8</sup>

If, whatever a man’s real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party’s terms.

In the Supreme Court<sup>9</sup> Lord Clarke recently restated the principle in these terms:<sup>10</sup>

The general principles are not in doubt. Whether there is a binding contract between the parties and, if so, upon what terms . . . depends not upon their subjective state of mind, but upon a consideration of what was communicated between them by words or conduct, and whether that leads objectively to a conclusion that they . . . had agreed upon all the terms which they regarded . . . as essential.

This principle, known as the objective test of agreement was applied in *Centrovincial Estates plc v Merchant Investors Assurance Co Ltd*<sup>11</sup> where the claimants purchased commercial property let to the defendants at a rent of £68,320 p.a. subject to review. The claimants erroneously suggested a new rent of £65,000 p.a. when they actually intended £126,000 p.a. Unsurprisingly, the defendants quickly accepted the mistaken offer. The Court of Appeal allowed the appeal from the judge’s declaration that there was no binding agreement to let the premises for £65,000.<sup>12</sup> Slade LJ applied the:<sup>13</sup>

well-established principle of the English Law of contract that an offer falls to be interpreted not subjectively by reference to what has actually passed through the mind of the offeror, but objectively, by reference to the interpretation which a reasonable man<sup>14</sup> . . . would place on the offer.

The claimants argued that no reasonable person would expect the rent to be reduced. However, the defendants countered that they reasonably anticipated some concessions due to their dissatisfaction with the conduct of the previous term. The Court of Appeal held that this was at least an arguable position. Similarly in a case<sup>15</sup> concerning an export transaction the High Court of Australia applied the objective approach to the construction of letters sent by the seller’s bank to the time charterer of a vessel carrying goods apparently

<sup>8</sup> *Smith v Hughes* (1871) LR 6 QB 597.

<sup>9</sup> In the Privy Council see also Lord Hoffmann’s statement in *A-G of Belize v Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988 at para 16 that a court is ‘concerned only to discover what the instrument means . . . [but] that meaning is not always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person’.

<sup>10</sup> *RTS Flexible Sysytems Ltd v Molkerei Alois Muller GmbH & Co KG* [2010] UKSC 14, para 45. See also *Maple Leaf Macro Volatility Master Fund v Rouvroy* [2009] EWCA Civ 1334, [2010] 2 All ER (Comm) 788. [1983] Com LR 158.

<sup>12</sup> Due to the preliminary nature of the proceedings, this does not amount to a holding by the court that there existed a contract to re-let at the lower rent, but rather that it was reasonably *arguable* that this was so.

<sup>13</sup> At p. 158.

<sup>14</sup> It has been suggested that the test of the reasonable man disguises a number of different personae. See Howarth (1984) 100 LQR 265; Vorster (1987) 103 LQR 274.

<sup>15</sup> *Pacific Carriers Ltd v BNP Paribas* (2004) 208 ALR 213.

indemnifying the latter against claims brought against it when difficulties were encountered unloading the cargo. The letter writer's subjective understanding of the effect of her letter was said to be irrelevant when a reasonable person in the position of the recipient would interpret the document as an indemnity. In another case<sup>16</sup> following shortly after, the same court criticised 'the reasoning of the learned primary judge . . . [in particular] the attention that was given to largely irrelevant information about the subjective understanding of the individual participants in the dealings between the parties'.<sup>17</sup>

The 'objective' theory of agreement creates an incentive in those negotiating contracts to carefully consider all communications to parties with whom they wish to enter a contract. In *Centrovincial* the landlord's lack of care may have resulted in an obligation to let premises at an undervalue. In another case, a party to a financial agreement was not protected by a number of clauses typically included in such contracts because he failed to analyse carefully a number of clear and legible faxes he received outlining the removal of certain typical clauses from the usual financial agreement.<sup>18</sup> The only 'escape' for the parties disadvantaged in the transactions above would be if they were able to bring themselves within the so called doctrine of 'snapping up' which we have already examined,<sup>19</sup> i.e. they could show that there had been a mistake as to the terms proposed and that the person proposing those terms, the offeror, was aware of the other party, the offeree's mistake. The court's approach has been to require that this 'escape' be proved strictly in order to avoid the opportunistic contractor from seeking to avoid a contract merely on the grounds that he had made a bad bargain.<sup>20</sup>

## Offers and invitations to treat

An offer is a definite promise to be bound, provided that certain terms are met. A vague invitation to begin negotiating does not amount in law to an offer and is referred to as an invitation to treat. This can be illustrated by reference to the famous case of *Carlill v Carbolic Smoke Ball Co.*<sup>21</sup>

The defendant company manufactured a product called the 'Carbolic Smoke Ball'. In an advertisement it offered to pay £100 to anyone who caught influenza after having used the Smokeball in a specified way, and stated that it had deposited £1,000 with its bankers to demonstrate the company's 'sincerity' in this matter. The claimant, who had used the Smokeball in the prescribed way and caught influenza, claimed the £100.

The defendant advanced a number of arguments in order to avoid liability, including the suggestion that the advertisement was a mere sales 'puff' and not intended to have legal effect. From this argument and the way it was rejected by the Court of Appeal it can be seen that there is a close relationship between the distinction we are presently considering and the requirement of an intention to create legal relations. In *Carlill* the Court of Appeal



<sup>16</sup> *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd and Others* (2004) 211 ALR 342.

<sup>17</sup> Para 35.

<sup>18</sup> *Icon Capital UK Ltd v Michael Gerson (Leasing) Ltd* [2003] EWHC 736 (Comm).

<sup>19</sup> Chapter 2.

<sup>20</sup> *Clarion Ltd v National Provident Institution* [2000] 1 WLR 1888, *AGGO International Ltd v Service Co AG* [2005] EWHC 1206 (Com).

<sup>21</sup> [1892] 2 QB 484. See the fascinating discussion of the background to the case by Simpson at (1985) 14 LS 345.