

CHAPTER 2: Contract Formation

- Chapter 2 looks at preconditions that must be satisfied for a promise to be contractual: these are that:
 - There must be an agreement between the parties containing one or more promises
 - Consideration must be provided for those promises
 - The parties must intend for their agreement to be legally binding
 - The parties must have the legal capacity to make a contract
 - The agreement must comply with any formalities required by law

Introduction

- The central requirement of a contract is the existence of an agreement between two parties concerning the promise in question
- In particular the following should be examined
 - The nature of an agreement
 - The offer and acceptance process used in connection with this requirement
 - The situations in which agreements can be reached without a discernible process of offer and acceptance
 - The need for the agreement to concern a promise, and the distinction between bilateral and unilateral agreements

The Nature of An Agreement

- **An agreement is an understanding between two parties that one of them will do something, or will promise to do so, in return for the other doing something, or promising to do so**
- Two elements to an agreement
 - Meeting of the minds of the parties
 - At least one promise from the parties
- The promise is what differentiates contractual agreements from other types of agreements
- Also, essential that the agreement is entered into voluntarily i.e. not the result of illegitimate pressure being exerted by one party onto another
- **Whether parties have reached an agreement is determined objectively not subjectively**
 - This involves making a decision based on the conclusions a reasonable person would draw from the behaviour of the parties
 - If such a person would think that the parties had reached an agreement, then neither party will be allowed to say that they did not to contract on the terms apparently agreed upon
 - **Regard is paid to subjective matters such as fraud, misrepresentation and mistake which might prevent an agreement from being reached**
 - **The presence of these matter will either void the agreement automatically or allow the innocent party to do so at their option**
- **Agreement is required only about entering into the contract; It is not concerned with the desirability of doing so or what motivates the parties.**
 - Agreement does not mean hat the parties must have discussed and consciously assented to each and every one of its terms

- Often one party will merely indicate that the terms proffered by the other are acceptable, without having read or understood those terms
- **An agreement can exist even though one or both of the parties believes that they are obliged to enter into the contract because of their economic or personal circumstances**
 - Agreement can also exist even though one of the parties is not happy about its terms and has entered into it only reluctantly
 - ***As a general proposition, the law does not prevent that power being used to drive bargain that is overwhelmingly general in that party's favour***

Smith v Hughes [1871] 6 QB 597

- S offered to sell H oats
- S showed him oats, and H believing they were old oats agreed to purchase them at the price stated by S
- When H discovered they were new oats, H sought to return them and avoid paying
- S refused to take them back and sued for the contract price
- Court claimed that both parties were agreed as to the sale and purchase of oats and that the defendant believed the oats to be old, and thus was induced to agree to buy them, HOWEVER HE OMITTED TO MAKE THE AGE OF THE OATS ARE CONDITION OF THE CONTRACT
- **HELD: whatever a man's real intention may be, he so conducted himself so that a reasonable man would believe that he was assenting to the terms proposed by the other party and that the other party upon belief enters into a 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**

Offer and Acceptance

- **In most cases, the issue of whether an agreement has been reached is determined by analysing the dealings between the parties in terms of offer and acceptance**
 - This analysis involves determining whether an offer has been communicated to a party and whether the latter has accepted this offer
- a) Offer
 - **An offer is a promise by one person 'the offeror' to do something, or not do something if the person to whom it is addressed 'offeree' responds in a stipulated matter**
 - Any form of words or conduct intentionally communicating such a promise can amount to an offer
 - E.g. stating a willingness to sell goods or services in exchange for a price
 - Advertising a reward/price that will be paid to anyone providing certain information
 - Making a bid at an auction
 - Submitting a tender
 - Communications of this nature should be distinguished from statements of fact, expressions of opinion, representations about the future or statements of policy, which are not offers
 - NOT OFFERS BECAUSE THEY ARE NOT PROMISES MADE IN EXCHANGE FOR SOMETHING SOUGHT FROM THE PROMISE

b) Acceptance

- **An acceptance is an affirmative response to an offer by the offeree, in effect the offeree saying yes**
 - Clearest way to do so is to state this literally in writing or orally
- Overall, any words or conduct can amount to an acceptance, as long as an intention can be discerned on the part of the offeree to accept the offer on the terms stipulated

c) The importance of the offer and acceptance process

- The process of analysing the communications and conduct of the parties in terms of offer and acceptance is not only used to determine *whether* an agreement has been made but also *when and where the agreement was made*
- The general rule is that an agreement is reached when and where the offeree's acceptance is communicated to the offeror

The Nature and Duration of Offers

a) To whom can the offer be made?

- An offer can be made to a particular person, to a group or to the whole world.
- **Carlill v Carbolic Smoke Ball Company**
 - The carbolic smoke ball was designed to prevent users contracting a cold or influenza
 - The company published an advertisement which stated that \$100 will be granted to anyone who contracts influenza even after using the ball as directed
 - Carlill bought the ball and used as recommended, yet still contracted influenza
 - She claimed the prize, but then the company appealed
 - **COURT HELD: that the prize was an offer made to the world and a contract can be made with anybody who comes forward and performs the condition on the faith of the advertisement**

b) Offers distinguished from invitations to deal

- Most legal systems draw a distinction based upon the intention of the party making the communication between an offer, and an invitation to deal- sometimes referred to as an invitation to treat
- **A communication is an offer if the party making it intended an affirmative response that would immediately give rise to an agreement**
- **If the communication was intended to merely initiate negotiation, it will be characterised as an invitation to deal**
- Important to distinguish as one leads to an agreement and the other leads to a potential offer being made
- There are several communication problems which give rise to whether the communication is an offer or an invitation

DISPLAYING GOODS

- The display of goods is an invitation to deal rather than an offer
- This issue is important because it is important to determine the point in time when a contract of sale is made, and whether a customer insists upon purchasing goods they have selected
- **Pharmaceutical Society of Great Britain v Boots Cash Chemists**
 - Boots operated a self-service store where customers wishing to purchase items from the store, selected them from the shelves and took them to the cashier's desk and paid for them
 - Pharmaceutical society alleged that by operating in this manner Boots infringed the Pharmacy and Poisons Act as they were enabling unsupervised purchases of drugs
 - **COURT HELD: although the goods are displayed with a price on the shelf, this is merely an invitation to treat. The contract and transaction was made when the customer took the basket of goods to the cashier. Here is where the offer is made by the customer to the cashier. The contract is formed when the cashier takes the customers money and completes the transaction (acceptance).**

AUCTIONS

- An auction involves three parties
 - The seller
 - The auctioneer
 - The bidder
- The auction may be advertised as being subject to a reserve price
- The issue is whether the communication to sell to the highest bidder is an offer or merely an invitation to treat
- **AGC Ltd V McWhirter**
 - During the auction, the auctioneer announced that an initial reserve had been withdrawn, whereupon McWhirter bid the highest price
 - He was informed that this bid was not acceptable, and the property was knocked down to an earlier bidder for a lower price
 - McWhirter's claimed that they were entitled to the land under a contract made at the auction
 - **COURT HELD: An auction remains an invitation to treat. If there is a reserve price notified, it indicates to bidders that an offer below the reserve price will or may not be considered. If the auction is without a reserve price then the bidder with the highest bid merely makes an offer and the acceptance is confirmed when the auctioneer brings down the hammer, signifying that a contract has been formed**

ADVERTISEMENTS

- Advertisements are merely an invitation to treat
- If all people contracted with an advertiser, beyond the advertiser's anticipated amount, then there may be contracts they have no capacity to honour
- Thus, responses to advertisements can only be offers
- However as seen in Carlill v Carbolic Smoke Ball Company, this is not always true
- **Lefkowitz v Great Minneapolis Surplus Store**

- The defendant published an advertisement which stated that they had 3 brand new fur coats worth \$100 each and the first 3 customer served would receive them for \$1
- Whether in any individual instance a newspaper advertisement is an offer rather than an invitation to treat depends on the legal intentions of the parties and the surrounding circumstances
- In this case, the fur coats were clear, definite and explicit and left nothing open to negotiation
- Hence, the place of business was entitled to performance
- **HOLD: there was the conduct of the parties a sufficient mutuality of obligation to constitute a contract sale**

CALLS FOR TENDER

- **A call for tender will usually be regarded as merely an invitation to make an offer which, if made, can be accepted or rejected by the person making the call**
 - However, a call for tender may contain an undertaking to treat the tender in a specified manner which the law will characterise as an offer
 - By submitting a tender, the invitee accepts this offer and thereby creates a contract in the terms of the undertaking, regardless of whether the tender itself is ultimately accepted or not
 - **Blackpool and Fylde Aero Club Ltd v Blackpool Borough Council**
 - Council invited the Aero Club and six other parties to tender for the operation of pleasure flights from its airport
 - These invitations stated that tenders were to be submitted in an envelope provided that tenders received after a specified due date would not be considered FINISH!!!!
- c) Offers distinguished from responses to requests for information or statements of possible terms
- Offers are also distinguished from responses to requests for information about the subject matter of a possible contract and statements of the terms upon which a person may be willing to contract
 - This type of response to such a statement cannot be considered as an acceptance: at most it will be an offer to which the maker of the initial statement can choose to accept or reject
 - **Harvey v Facey**
 - Plaintiffs asked defendant how much they were willing to sell their land for
 - Defendants replied with a certain figure which the plaintiffs treated as an offer and then accepted
 - **HELD: council stated that the defendant's reply was merely a statement of minimum price at which they may have been willing to sell for, rather than an offer. Therefore, the plaintiff's communication could not amount to acceptance; it would only constitute as an offer which COULD be accepted or rejected by the defendants**
 - In *B Seppelt and Sons Ltd v Commissioner for Main Roads*, after noting that the characterisation of a communication as an offer, or not, was to be determined objectively by reference to the intention of the parties
 - The factors to be considered were:

- The inherent likelihood, or otherwise of the communication being an offer
- The terms of the communication passing between the parties
- Whether the parties contemplated the eventual involvement of lawyers
- Latter events