Week 5 : Contract Law
Intention to Create Legal Relations

Elements

- There are four elements of a contract
  - Offer
  - Acceptance
  - Consideration
  - Intention to create legal relations (ICLR)

Seriousness

- Contracts are not “mere matters of pleasantry and badinage” but should be intended to create a legal relationship between the parties
  - *Dalrymple v Dalrymple* (1811)

Please find the video from the link: https://www.youtube.com/watch?v=2Dy7YCdaR5g

Week 5 : Contract Law
Intention to Create Legal Relations

Domestic agreements

- Everyday agreements are common in a marriage but will generally not invite legal consequences
- However an intention to create legal relations is not impossible and it can be difficult to draw a line
  - *Balfour v Balfour* [1919]
  - *Merritt v Merritt* [1970]

Domestic agreements

- Often performance of an agreement will be persuasive in this context
  - *Pettitt v Pettitt* [1970]
- Similar considerations are relevant for parent-child relationships
  - *Jones v Padavatton* [1969]

Please find the video from the link: https://www.youtube.com/watch?v=2Dy7YCdaR5g

Week 5 : Contract Law
Intention to Create Legal Relations

Domestic agreements

- Other informal relationships may attract legal consequences if there is a clear mutuality in the arrangement
  - *Simpkins v Pays* [1955]

Commercial agreements

- There is a presumption that commercial agreements are intended to create legal relations although this can be rebutted:
  - 'Advertising puff' as discussed in *Carlill v Carbolic Smoke Ball Co* [1893]
  - Express declaration in the contract; *Rose and Frank v Compton* [1923]; *Kleinwort Benson Ltd v Malaysian Mining Corporation Bhd* [1989]

Please find the video from the link: https://www.youtube.com/watch?v=2Dy7YCdaR5g

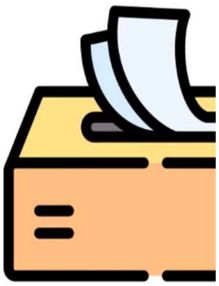
Week 5 : Contract Law
Intention to Create Legal Relations

Intention to Create Legal Relations

Introduction to Intention

- Intention to be bound is essential
- No intention = no contract, see **Rose and Frank v Compton Bros (1925)**

  "To create a contract there must be a common intention of the parties to enter into legal obligations, mutually communicated expressly or impliedly"



- The test of intention is objective
- Normally, a distinction is made between:
  - Commercial / business agreements; and
  - Social / Domestic agreements

Please find the video from the following link: https://youtu.be/MPsdiqqp7bw

Week 5 : Contract Law
Intention to Create Legal Relations

Intention to Create Legal Relations

- **Commercial / Business Agreements**
  - There is a strong (but rebuttable) presumption that ICLR exists – ***Rose and Frank v Compton Bros (1925)***
  - On the basis that a reasonable person in this scenario would expect there to be an intention
  - Main exception to the presumption
    - Mere puffs – ***Weeks v Tybald*** **(1604)**

Intention to Create Legal Relations

- **Social / Domestic Agreements**
  - There is a strong (but rebuttable) presumption that ICLR does not exist
    - Husbands and wives – ***Balfour v Balfour*** **(1919)**
    - Parents and Children – ***Jones v Padavatton*** **(1969)**
    - Housemates – ***Simpkins v Pays*** **(1955)**
  - Factors such as certainty of terms, seriousness, and reliance are all important

Please find the video from the following link: https://youtu.be/MPsdiqqp7bw

Chapter 5

INTENTION TO CREATE LEGAL RELATIONS

5.1 INTRODUCTION

The parties must intend to be legally bound before the court will recognise the existence of an enforceable contract. The leading case is *RTS Flexible Systems Limited v Molkerei Alois Müller GmbH & Co KG* [2010] 1 WLR 753. The court determines the parties' intention as a whole based on the particular facts of each case, which are objectively assessed. It does not consider their subjective states of mind. The words used, conduct, circumstances and the relationship between parties are all relevant considerations. Even if certain terms of economic or other significance to the parties have not been finalised, an objective appraisal of their words and conduct may lead to the conclusion that they did not intend agreement of such terms to be a pre-condition to a concluded and legally binding agreement. In a commercial context, the onus of demonstrating that there was a lack of intention to create legal relations lies on the party asserting it and it is a heavy one.

The courts distinguish between domestic and commercial agreements.

5.2 DOMESTIC AND SOCIAL AGREEMENTS

There is a rebuttable presumption that domestic and social agreements, such as those commonly exchanged between family members and friends, are not intended to be legally binding.

(a) Between husband and wife

Agreements between spouses living together in harmony are presumed to be unenforceable, unless the agreement states to the contrary. The onus is on the claimant to rebut the presumption. In *Balfour v Balfour* [1919] 2 KB 571 the husband was posted to Sri Lanka. The wife remained in England for health reasons. The husband promised to pay her £30 per month until she returned to Sri Lanka. He subsequently wrote to her and said that it would be better if they remained apart. The wife obtained a divorce and her action to enforce her now ex-husband's broken promise was rejected in the Court of Appeal. Notwithstanding the want of consideration, Atkin LJ was of the view that, unless facts are pleaded to rebut the presumption against enforceability, domestic arrangements of this nature are clearly not intended to be binding on the parties.

The strength of the presumption depends on the closeness of the relationship and other circumstances. The presumption will not apply where the spouses are estranged or no longer living together at the time of the agreement. In *Merritt v Merritt* [1970] 1 WLR 1211, the husband, who had separated from his wife, agreed in writing to transfer the matrimonial home out of their joint names into the wife's name alone, provided she paid off the remaining mortgage debt. The husband's promise was held to be legally enforceable after the wife paid off the mortgage. Agreements between separated couples may still be enforceable for lack of certainty. For that reason, in *Gould v Gould* [1969] 3 All ER 728 an undertaking by a husband to his estranged wife that he would pay her £15 per week "so long as I can manage it" was held to be non-binding.

(b) Between parents and children

Domestic agreements are presumed not to have legal effect with regard to parents and children. In *Jones v Padavatton* [1969] 2 All ER 616, a mother bought a house in London

for her daughter with the intention that the daughter should live there and support herself by renting out the spare rooms. The daughter subsequently moved to London in order to study law. Mother and daughter became estranged after the daughter failed to pass the Bar exam. The mother claimed possession of the house but the daughter argued she had a contractual right to remain there. The Court of Appeal held that an agreement between parent and child fell into the same category as an agreement between husband and wife. The daughter failed to rebut the presumption against an intention to create legal relations, since the parties were on good terms when the arrangement was made.

(c) *Social agreements between non-relatives*

There is a presumption against an intention to create legal relations in social situations. In *Lens v Devonshire Club* [1914] *The Times* 4 December, the winner of a local golf club competition could not bring a claim for a prize where "...no one concerned with that competition ever intended that there should be any legal results flowing from the conditions posted and the acceptance by the competitor of these conditions...". The court will, however, examine all the circumstances of each case and the presumption can be rebutted where the claimant can show that reliance has been placed on the agreement. In *Simpkins v Pays* [1955] 1 WLR 975, a grandmother, her daughter and their paying lodger jointly entered a weekly newspaper competition. They had agreed to share the cost of entry, although the application was solely in the name of the grandmother. The arrangement was held to be a joint enterprise to which cash was contributed in the expectation of sharing any prize. There was a shared acknowledgement that the parties intended the agreement to be legally binding.

5.3 COMMERCIAL AGREEMENTS

There is a presumption in favour of intention to create legal relations regarding commercial agreements. The presumption of enforceability can be rebutted, but very clear evidence must be shown in order to do so. In *Edwards v Skyways* [1964] 1 WLR 349, an airline pilot was offered an *ex gratia* 'golden handshake' payment by his employers. They failed to pay and the pilot sued. The employers claimed that the offer of the *ex gratia* payment was not intended to be contractually binding. However, the court held that the burden of proof in a commercial agreement was on the person asserting that no legal effect was intended. The employers had failed to discharge the burden.

The presumption of enforceability may be rebutted in the following instances:

5.3.1 EXPRESS EXCLUSION OF INTENT

Where the presumption of contractual intention is expressly displaced by the specific wording of the agreement in question, the presumption may be rebutted. Transactions made 'subject to contract', letters of intent, letters of comfort and honour clauses are generally unenforceable.

5.3.1.1 Letters of Intent

A letter of intent is a document in which one party indicates that he intends to contract with the other in future, but is not yet ready to create contractual obligations. This often occurs where further information is sought, for example, to price up a tender on the basis of that subcontractor's involvement, but where the inquiring party does not wish to be bound by that price at the initial stage of negotiations. In *British Steel v Cleveland Bridge* (1981) 24 BLR 94, British Steel supplied an amount of cast steel to Cleveland Bridge pursuant to a letter of intent. The parties discussed the terms of, but never actually formalised, a contract. British Steel's delivery of the steel was late. British Steel claimed what it said was the contract price of the

steel. Justice Robert Goff reasoned that any contract formalised, following a letter of intent, may take either one of two species: (1) an ordinary executory contract; or (2) an "if" contract, i.e. a contract under which A requests B to carry out a certain performance and promises B that, if he does so, he will receive a certain performance in return. He held that there was clearly no contract, merely an obligation on the part of Cleveland Bridge to pay a reasonable price for the work carried out and the materials delivered. Where there is nothing in the letter to negate contractual intention, the letter may be held as forming a binding agreement, especially where the parties have acted on the basis of the document for a long period of time or have incurred expenditure in reliance on it.

5.3.1.2 Letters of Comfort

A comfort letter is usually written by a holding company to a lender about to lend money to a subsidiary of the holding company in order to reassure the lender of the financial viability of the subsidiary. These letters are not guarantees as the holding company is not willing to enter into a legally binding financial commitment. In *Kleinwort Benson Ltd. v Malaysia Mining Corp. Bhd* [1989] 1 All ER 785, the claimant bank agreed to make a loan facility to the defendant's subsidiary. As part of the arrangement, the defendant provided two 'letters of comfort', each stating that "it is our policy to ensure that the (subsidiary's) business is at all times in a position to meet its liabilities to you". The subsidiary went into liquidation and the bank claimed from its holding company, The Court of Appeal held that the letters of comfort were statements of present fact – rather than contractual promises as to future conduct. They were not intended to create legal relations and gave rise to no more than a moral responsibility, on the part of the defendant, to meet its subsidiary's debt. No promise could be implied, where it was not expressly stated.

5.3.1.3 Honour Clauses

Inserting an 'honour clause' is a common method of rebutting the presumption of contractual intention in a commercial contract. It shows that there is no intention to be legally bound. Accordingly, where a commercial agreement stated: "This arrangement is not entered into...as a formal or legal agreement and shall not be subject to legal jurisdiction in the Law Courts... ... but it is only a ... record of the purpose and intention of the ... parties ... to which they each honourably pledge themselves ... based on past business...", the claimant's action for breach of contract and non-delivery of goods failed for want of a binding agreement (*Rose and Frank Co. v Crompton Bros Ltd.* [1925] AC 445).

5.3.2 PROMOTIONAL OFFERS

A similar conclusion was reached in *Esso Petroleum Ltd v Commissioners of Customs and Excise* [1976] 1 All ER 117. Esso supplied garages with promotional 'World Cup' coins. One coin was given away to motorists with every four gallons of petrol purchased and could be collected to make a set. The coins were virtually worthless in themselves. The question, as far as Customs and Excise were concerned, was whether Esso were liable to pay a sales tax on the coins (advertised as 'free' at Esso garages at the rate of one coin to every four gallons of petrol purchased). This question in turn hinged on whether the coins were *sold* to the motorist. While the majority of the House of Lords held that there had been no sale and Esso was not liable for the sales tax, it decided that the petrol station's price indications were invitations to treat. The giving away of promotional material *ex gratia* formed part of a general offer, or unilateral contract. This unilateral contract ran parallel with the main contract of sale (an amount of petrol for an agreed sum). There was, therefore, legal intent despite the coins having virtually no intrinsic value.

5.3.3 MERE PUFFS

Advertising 'puffs' are vague or exaggerated claims in advertising. Generally, they are statements of opinion and do not attract contractual liability. However, if a pledge is specific, such as the form of a money-back guarantee, it is more likely to be binding; see *Carlill* case (*supra*).

5.3.4 COLLECTIVE AGREEMENTS

Collective agreements between employers and trade unions are presumed not to give rise to legal relations. They are, therefore, generally unenforceable in the courts, unless there are *clear and express* provisions to the effect that they are legally binding (*Ford Motor Co Ltd v AUEFW* [1969] 2 QB 303).

Statute has subsequently intervened to provide that *no* contractual intention exists in certain cases. Section 179 of the Trade Union and Labour Relations (Consolidation) Act 1992 states that agreements between trade unions and employers regulating rates of pay and conditions of work are not intended to be legally enforceable, unless they are written and expressly affirm that they are to be binding.

5.4 AGREEMENT TO AGREE

It is a well-established principle in English law that an agreement to agree is unenforceable due to uncertainty and will be considered as 'incomplete' (and therefore not legally binding on the parties) until the final agreement is executed (*Walford v Miles* [1992] 2 AC 128).

On the other hand, sometimes an agreement to agree can also be fully enforceable if it contains sufficiently definite terms and adequate consideration, even if it leaves certain details to be negotiated later by the parties. This may often create uncertainty as to the enforceability.

The Court of Appeal, in a recent decision, held that an agreement between two parties to negotiate in good faith the terms of later agreements, which are uncertain in their terms, will not be enforceable in law (*Georgi Barbudev v Eurocom Cable Management Bulgaria Eood & Ors* [2012] EWCA Civ 548).

However, in the recent case of *MRI Trading AG v Erdenet Mining Corporation LLC* [2013] EWCA Civ 156, the Court of Appeal distinguished between two situations:

- "*....if on the true construction of the words which the parties have used in the circumstances in which they have used them, the parties must be taken to have intended to leave some essential matter, such as price or rent, to be agreed between them in the future—on the basis that either will remain free to agree or disagree about that matter—there is no bargain which the courts can enforce....*".

- "*....if the court concludes that the true intention of the parties was that the matter to be agreed in the future is capable of being determined, in the absence of future agreement, by some objective criteria of fairness or reasonableness, then the bargain does not fail because the parties have provided no machinery for such determination, or because the machinery which they have provided breaks down. In those circumstances the court will provide its own machinery for determining what needs to be determined—where appropriate by ordering an inquiry (see Sudbrook Trading Estate Ltd v. Eggleton [1983] A.C. 444)...*"

In the case of *MRI Trading AG*, the court determined that the agreement was enforceable, despite there being provisions that still had to be agreed, stating that:

> "*In circumstances where the parties had agreed every other aspect of the contract, including quality, specification and price, and where they had stipulated for the arbitration of disputes by a market tribunal, it is almost perverse to attribute to them an intention not to conclude a binding agreement, a fortiori where the agreement was an integral part of a wider overall transaction compromising an earlier dispute*".

The Court of Appeal reviewed several authorities in its judgment, and further mentioned that the principles relevant to that case were not intended to be in any way an exhaustive list; each case should therefore be decided on its own facts and on the construction of its own agreement.