

# Consideration in contract formation



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Consideration is essential to the formation of any contract made without deed. It distinguishes a bargain or contract from a gift. Lush J in the case of *Currie v Misa* (1875) referred consideration consist of a benefit to the promisor or a detriment to the promisee as: “ Some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by other”. Lord Dunedin in *Dunlop v Selfridge* (1915) defined consideration as:

“ An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable”. However, it is much wider in Section 26 of the Contracts Act 1950; the general rule of an agreement without consideration is void and is defined in Section 2(d) of the Contracts act 1950 as follows: “ When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”.

*Guthrie Waugh Bhd V Malaippan Muthucumaru* (1972) The court held that as far as the defendant was concerned, the deed was executed by him neither for any past consideration, nor in respect of forbearance to sue him for the supplies made to the estates, nor in consideration of any promise to supply him goods on credit in future. Therefore, there was no cause of action as the claim based on deed agreement for which there was no consideration and the defendant could be said to have undertaken was a moral obligation. (Lee Mei Pheng, 2005)

There are few elements governing the law of consideration in Malaysian law:

1. Consideration Need Not Be Adequate , But Must Be Sufficient There is no requirement that the consideration must be at market value, as long as the promisee provides something in value i. e. ? 2 for an exchange of a car would be valid. The courts are not concerned the adequacy. Chappell & Co V Nestle (1960) Nestle had a special offer involving if customers sent in 1s6d and three chocolate bars wrappers, they would get a record of a song called ‘ Rockin Shoes’.

Chappell & Co who owned the copyright of the song has brought an action for breaches of copyright and claimed royalties. Nestle willing to pay the royalties at 6. 25% of 1s6d however Chappell & Co argued that it should include the chocolate wrappers although Nestle thrown it away after they received it. The court held that consideration must be sufficient but need not be adequate; hence, the chocolate wrappers were part of consideration as it was part to increase sales and provided value. Therefore, Chappell & Co were granted the injunction and Nestle could not sell the records.

Under the Malaysian Law, explanation 2 to Section 26 of Contracts Act 1950 provides that an agreement to which the consent of the promisor is not void merely because the consideration is inadequate; but the inadequacy will be question by the court whether the consent of the promisor is freely given.

The illustration (f) to Section 26 of Contracts Act 1950 clearly states the application of the rule: “ A agrees to sell a horse worth RM 1, 000 for RM 10. A’s consent to the agreement was freely given. The agreement is a contract notwithstanding the inadequacy of the consideration”.

This was illustrated in the case of *Phang Swee Kim v Beh I Hock* (1964), the respondent's solicitor notified the appellant that she had trespassed on the said land and claimed for vacant possession and for an account of all income received by her from the land. In May 1963, the respondent instituted an action against her claiming the relief stated. The appellant counter-claimed for a declaration that she was entitled to the said land. At the hearing, the appellant contended that there was an oral agreement made between her and the respondent in which the respondent agreed to transfer the land to her on payment of \$500 in 1958.

The learned trial judge accepted her evidence, but held that the agreement is void due to inadequacy of consideration. However, on appeal the Federal Court held that by virtue of explanation 2 to Section 26 of Contracts Act 1950, there was adequate consideration as being no evidence of misrepresentation or fraud. The appellant was therefore entitled to the declaration sought by her.

## 2. Past Consideration Is Valid Consideration

If one party voluntarily performs an act before the promise was made, the consideration for the promise is said to be in the past. Generally, English law does not recognise past consideration.

If something is done in the business context and it was understood that both parties that it would be paid off, then past consideration is valid. In *Re McArdle* (1951), after the death of the mother, five children inherited the house. One of the daughters in law paid for some home improvements. Later, the other four children signed a document that promised to pay her 488 for the work, in consideration of carrying out improvements to the property. However, the others refused to pay and the Court of Appeal held

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that the promise was unenforceable as all the work had been done before the promise made, was therefore a past consideration.

At the promisor's request to provide goods and services previously, then promise made after the provision of goods will be binding. It applied to the case *Lampleigh v Braithwait* (1615). Braithwait killed someone and asked Lampleigh to get him a pardon. In exchange, he promised to pay ? 100 for his efforts but never paid. The court held that it appears to be unspoken understanding that the service would be paid for and so was not past.

However, in Malaysian law past consideration is valid consideration according to Section 2(d) and 26 of Contracts Act 1950.

The words “ has done or abstained from doing” implied that even if the act done was prior to the promise, such an act would constitute consideration as long as it was done at the desire of the promisor (Lee Mei Pheng, 2005). It is illustrated in the case of *Kepong Prospecting Ltd & Ors v Schmidt* (1968), the court held that the services prior to the company's formation could not amount to consideration as they could not be rendered to a non-existent company, nor could the company bind itself to pay for services claimed to have been rendered before its incorporation.

Nevertheless, the inclusion of that ineffective element did not prevent the other two elements. (Lee Mei Pheng, 2005) The following case illustrates the application of the provisions relating to ‘ past’ consideration. In *South East Asia Insurance Bhd v Nasir Ibrahim* (1992), it was an action of indemnity and the Supreme Court held that the essence of consideration is that the promisee has taken upon itself some kind of burden or detriment. In deciding

whether the consideration is past, the Court should not take a strictly chronological view.

If the consideration and the promise are substantially one transaction, it should not matter in what order they are given. In this case, where the appellant and where the respondent executed the third party indemnity signed a performance bond, the Supreme Court allowed the appellant's appeal and held that the third party indemnity was valid on the ground of past consideration.

### 3. Consideration Need Not Move From The Promisee

If a person provides consideration other than the promisee then the promisee cannot enforce the contract. If the third party involved then problems may arise. In *Price v Easton* (1833), Easton made a contract with X that in return for X doing work for him; Easton would pay Price ? 19. X did the work but Easton did not pay, so Price sued. It was held that Price's claim failed, as he had not provided consideration. However, under Malaysian law, promisee or third party may provide consideration.

Section 2(d) of Contracts Act 1950 provides that "...when...the promise or any other person has done...something, such act...is called a consideration for the promise..." This principle applied in *Venkata Chinnaya v Verikatara Ma'ya* (1881), a sister agreed to pay an annuity of Rs653 to her brothers who provided no consideration for the promise. But on the same day their mother had given the sister some land, stipulating that she must pay the annuity to her brothers. The sister subsequently failed to pay the annuity and was sued by her brothers. The court held she was liable to pay the annuity.

There was good consideration for the promise even though it did not move from her brothers. 4. Part Payment Of Debt In common law, a smaller sum of payment is not a satisfaction of an obligation to pay a larger sum. It applied in Pinnel's case (1602), the claimant was owed ? 8. 5 and defendant paid ? 5. 11. The court held that an acceptance of part payment would be binding. If the debtor's provided some consideration in the request of the creditor's i. e. part payment before due date, with chattel instead of money and part payment in a different place. The rule was affirmed in Foakes v Beer (1884), the claimant was owed ? 2090, and accepted ? 500 with installments on the remainder.

The House of Lords held that Mrs. Beer was entitled to the accrued interest of ? 360. There are further exceptions to the rule in Pinnel's rule: Part Payment Made By The Third Party An acceptance of smaller sum of the payment made by a third party in full satisfaction will be binding on creditor with condition the debtor is discharged from the obligation to pay entire debt. It applied in Hirachand Punamchand v Temple (1911), a father paid a smaller sum to the creditor on son's debt that he accepted as full settlement, later the creditor sued for remainders.

The Court held that the part payment was valid consideration, and the claim would be a fraud to the father. Composition Arrangement It is an agreement between a debtor with a group of creditors who agree to accept percentage of the debt as full settlement. Despite the absence of consideration, the Court will not allow a creditor to claim the balance. It is illustrated in Woods v Robarts (1818), Promissory Estoppel The doctrine of Estoppel is a principle of

equity and when it is successfully invoked with the nonexistence of consideration.

This principle established in the case of *Hughes v Metropolitan Railway Company* (1877), the landlord gave his tenant 6 months notice in order to do some repairs or else the lease would be forfeited failure to do so. There were negotiations for the sale of premises between the landlord and the tenant, however it ended without agreement. Meanwhile, the tenant had not done the repairs, and the landlord forfeited the lease. The House of Lords held that the landlord could not do so and that the tenant's defense of Promissory Estoppel was successful. Therefore, the notice will work again if the negotiations had broken down.

*Central London Property Trust Ltd V High Trees House Ltd* (1947) The plaintiff lease a block of flats at an annual rent ? 2500. Due to the World War II, it was difficult for the defendant to find tenants. Therefore, the plaintiff agreed to reduce the rent to ? 1250. However when the flats were occupied again, the plaintiff claimed for the balance of the rent. The Court held that the plaintiff was entitled to the arrears rent during the war period. Lord Denning J stated obiter dicta, if the plaintiff claimed the full rent between 1940-1945, they would have failed.

It suggests that Promissory Estoppel can destroy rather than suspend rights. (Elliot and Quinn, 2007) Promissory Estoppel occurs when there is a pre-existing contractual relationship, the promisor must give clear and unambiguous statement, the promisee must have acted in reliance on that promise, and it must be inequitable for the promisor to enforce strict legal



rights. In Malaysian Law, the rule in Pinnel's case is irrelevant and inapplicable. Illustration (b) and (c) to Section 64 of Contracts Act 1950, part payment of a debt has an effect to discharge the full debt.

It can be illustrated in the case of Kerpa Singh v Bariam Singh (1966), the debtor's son offered to give a cheque of RM4000 as full payment in order to discharge his father from a debt of RM 8650. The Federal Court held that since the creditor had accepted the offer by cashing the cheque and retaining the money, he agreed to discharge the debtor from any further liability. The principle of Estoppel was considered in Boustead Trading (1985) Sdn Bhd v Arab-Malaysian Merchant Bank Bhd (1995), the Court held that the doctrine of Estoppel is a flexible principle by which justice is done according to the circumstances.

It is a doctrine of wide utility and has been resorted to in varying fact patterns to achieve justice. It may be used as a shield but not a sword; it may assist a plaintiff in enforcing a cause of action by preventing a defendant from denying the existence of some facts that would destroy the cause of action. 5. Natural Love And Affection At common law, promise made in consideration of natural love and affection is void.

However, Malaysia recognises natural love and affection as Section 26(a) Contracts Act 1950 illustrated that an agreement without consideration is void unless it is expressed in writing, registered, and the parties stand in near relation to each other. In the case of Tan Soh Sim, deceased; Chan Lam Keong & Ors v Tan Saw Keow & Ors (1951), the court held that the validity of consideration depended on natural love and affection between near

relations, relationship and nearness depended on the mores of the group to which the parties belong and the circumstances of the particular family.

**Intention To Create Legal Relation** There must be an intention to create legal relation for an agreement to be legally binding. Although the Contracts Act 1950 does not specify provision governing the issue of intention, it appears that the Malaysia position is to be the same as the English position. The law divides agreements into two groups, social and domestic agreements, and business agreements.

1. **Social And Domestic Agreements** This group consist agreements between family members, friends, and colleagues. The law presumed that social agreement is not intended to be legally binding.

An agreement between husband and wife, *Balfour v Balfour* (1919), the defendant who worked in Ceylon promised to pay ? 30 monthly as maintenance fees, but he failed to keep up the payments when the marriage ended. The Court held that the agreement was not legally enforceable because the plaintiff did not provide consideration and there was no intention to create legal relation. The presumption against the contractual intention will not apply where the spouses are separating or divorcing. In *Merritt v Merritt* (1969), the husband left his wife and signed an agreement to pay ? 40 monthly for mortgage payments.

When the mortgage was paid off, he would transfer the house from joints name to the wife's name but he refused to transfer. The Court held that there was an intention to be binding as they made the agreement when they were no longer living together and it was evidenced by writing; therefore, the husband has to transfer the house to the wife's name. An agreement

between parent and child also not intended to be binding, Jones v Padavatton (1969), Mrs. Jones offered monthly allowance if her daughter would leave America and study to become a barrister in England.

The daughter accepted the offer and another agreement made where the daughter could rent out the rooms to support herself instead of allowance. Then, she failed the examinations and Mrs. Jones sought possession of the house. The Court of Appeal held that both agreements were family agreement and no intention to be binding, and the mother was not liable on the maintenance agreement and able to claim the possession of the house.

2. Business And Commercial Agreements There is a strong presumption that the parties intend to be legally bound and make a contract.

In the case of Esso Petroleum v Customs & Excise (1976), Esso had a promotion whereby anyone purchasing four gallons of petrol would get a free coin from their World Cup Coins Collection. The Customs and Excise Commissioners claimed that the coins is subject to tax if it produced in quantity for general resale then Esso would be liable to pay. The House of Lords held that there was an intention to be bound but the coins had been produced for distribution by way of gift not for resale. If a clause is ambiguous and put into an agreement, the Court will intervene and interpret it.

In Edwards v Skyways (1964), the defendant failed to pay an ex gratia payment and the pilot sued. It held that it was a business agreement and presumed to be binding. The Court also stated the word ' Ex Gratia' used to indicate the party agreeing to pay does not admit any pre-existing liability on

his part. A 'comfort letter' is a document written by a parent company or a government to a lender about the loan made to its subsidiary where the parent company or government is not willing to accept a legal commitment (Nuraisyah Chua Abdullah, 2003).

In *Kleinwort Benson Ltd v Malaysian Mining Corp. Bhd* (1989), the Court of Appeal held that the letters of comfort were statements of the company to present policy and not contractual promises as to future conduct and there were no intention to create legal relation. A 'letter of intent' was described as an expression in writing of a party's intention to enter into a contract but not ready to be bound (Nuraisyah Chua Abdullah, 2003).

In *Turriff Construction Ltd v Regalia Knitting Mills Ltd* (1971), the defendant wanted to build a Mill and informed the claimant that he would be granted a contract to build it. The letter of intent stated 'the whole to be subject to an acceptable contract'. While carrying out the preparatory work, the defendant abandoned the plan. The Court held that the claimant was entitled to claim for the preparatory work done. Generally, the application of the law of consideration has caused inconveniences as it can allow parties who make promises that morally to be binding to escape liability.

Under the Malaysian Law; firstly, the phrase of 'consideration need not be adequate but must be sufficient' has caused problem with sufficiency that it cannot be given enough value in return for a promise. Secondly, past consideration is valid but it is done before the offer made. Thirdly, 'consideration need not move from the promisee', this contradict to the

doctrine of privity of contract as in general the third parties cannot sue for the promise made by the parties to a contract.

Fourthly, part payment of debt is taken of full settlement. There will be equity if there is free consent in Section 14 of the Contracts Act 1950 provides there is no vitiating factors. Nevertheless, it is unfair if there is vitiating factors. Fifthly, natural love and affection, it caused a problem where love cannot be quantified, as individual measure love is different with another. Therefore, this legal principle should be removed and rely on intention to create legal relation because it helps to determine the boundaries of the contract.