

**Subject: Law of Contract-I**

**B.A.LL.B-IIInd Sem**

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**Teaching Material of Unit-II-a&b**

**Topic: Intention to Create Legal Relationship and Consideration**

### **Intention to Create Legal Relationship: A Separate concept of element**

#### *Intention of the parties*

As we have discussed under the heading formation of valid contract intention to create legal relations is one of the essential elements of contract that the two parties entering into a contract must necessarily have the intention to bind the other party with the involved legal obligations. Conversely speaking the agreements involving just some social or domestic obligations cannot constitute a contract.

Suppose an agreement was supported by consideration, but one of the parties claimed that it was never their intention to create a legally binding relationship. Thus, on the one hand, according to the principles of contract law, a contract is formed and binding. On the other hand, it was a part of the agreement itself that the agreement would not be binding. The courts have had to think through this consideration.

#### *Illustrative Examples*

The foundation for advancement of education announced to a college that it would give an award of rupees 20,000 to all the students who secure more than 90 per cent marks in the board examination. Mohan secured 92 per cent marks but the foundation refused to give the money to him as they had run out of funds. Does Mohan have a legal claim? The relationship between Mohan and foundation has all the constituents of a contract. The foundation has made a unilateral offer and Mohan has accepted it. The consideration for Mohan is rupees 20,000, and for the foundation it is performance of the condition of getting more than 90 per cent marks. It is an enforceable contract.

What on the other hand if Mohan's father had promised to give his son rupees 10,000 on securing more than 90 per cent marks but refused to fulfil it like the case of foundation, it has an offer, acceptance and consideration for both the parties

The father made a promise but never contemplated that he could be contemplated that h could taken to court of law to fulfil it. The father was committed enough to make the promise but never intended to go that far.

In other words, it was implied by the parties that they were not creating legal relations.

The Indian Contract Act does not provide for intention as a prerequisite for entering into a legal relationship. This prompted the Supreme Court to express its reservation about the need of this sperate concept of 'intention to contract' under the Act dehors (not including)the provisions of the same. The founding case on intention to create legal relation Balfour v/s Balfour applied in India. In following case, the Supreme court recognized the principle.

In *CWT v/s Abdul Hussain Mulla Mohd Ali*(1988)3 SCC562 the court observed that the requirement of intention was necessitated in systems where consideration was not arequisite for enforceability of contract.

However, the courts have applied the principle in certain cases and thus, it is not totally excluded.

### **English Law-**

Under the English law, a proposal must be intended to and capable of creating legal obligations. The parties must have intended to enter into binding legal obligations for creation of a contract. To create a contract there must be a common intention of the parties to enter into legal obligations.(Rose and Frank Co. case)

**Definition:** Intention to create legal relationship is defined as an intention to enter a legally binding agreement or contract. Intention to create legal relations is one of the necessary elements for the formation of a contract. It is therefore intention to create legal relations consists of readiness of a party to accept the legal sequences of having entered into an agreement. Intention

to create legal relations is a motion of every contracting party must have the necessary intention to enter into a legally binding contract.

### **Intention to Create Legal Relation**

Intention to create legal relationship: There must be an intention on the part of the parties to the agreement to create a legal relationship. Although there is no express provision in the ICA requiring that a proposal or its acceptance must be made with the intention of creating a legal relationship, yet, in the English law it is well settled principle that ‘to create a contract there must be a common intention of the parties to enter into legal obligations’.

In *Darlymple v Darlymple*,

it was observed that ‘contracts must not be the sports of an idle hour, mere matters of pleasantry and badinage, never intended by the parties to have any serious effect whatsoever’. The requirement of intention to create legal relations in contract law is aimed at sifting out cases which are not, in actuality, appropriate for court action. It is not that every agreement leads to a binding agreement which can be enforced through the courts. For example, X may have an agreement to meet his friend Y at a club. Over here, X may have a moral duty to honour that agreement, but certainly not a legal obligation to do so. This is because, in general, the parties to such agreements do not have it in mind to be legally bound. So as to determine which agreements are legally binding and have an intention to create legal relations, the law draws a distinction between ‘social and domestic agreements’ and ‘agreements made in a commercial context’. Whether or not an agreement is intended to have legal consequences is ascertained by the court with reference to the terms of the agreement, and facts and surrounding circumstances of the case. In commercial and business agreements, it is the presumption of law that the parties entering into agreement intend those agreements to have legal consequences. Nonetheless, this presumption may be negated by express terms to the contrary. For instance, in *Rose and Frank Co. v JR Crompton and Bros. Ltd.*, there was an agreement entered into between one American and two English firms for their dealings in paper tissues. One of the clauses included in the agreement read: ‘This arrangement is not entered into as a formal legal agreement and shall not be subject to legal jurisdiction in the law courts either in the US or in England’. It was held that this agreement was not a legally binding contract, for the parties intended not to have legal

consequences. Lord Atkin said, 'Intention to contract may be negated impliedly by the nature of the promise...If the intention may be negated impliedly, it may be negated expressly...I have never seen such a clause before, but I see nothing necessary absurd in businessmen seeking to regulate their business relations by mutual promises which fall short of legal obligations, and rest on obligations of either honour or self-interest or perhaps both.' Similarly, in *Jones v Vernon's Pools Ltd.*, there was an agreement which contained a clause that it 'shall not give rise to any legal relationships, or be legally enforceable, but binding in honour only'. It was held that the agreement did not give rise to legal relations and, thus, was not a contract. In the same way, in the case of agreements of purely domestic, family and social nature, the presumption of law is that the parties do not intend to give rise to legal consequences.

In our Indian law the intention to create legal relations is not given as an essential ingredient of contract law, but even the apex court of India has expressed its reservation about the need of this separate requirement of "intention to contract" under the Contract Act. It is sufficient if the parties show that consideration is part of contract to legally bind the parties. It is presumed that there exists an intention to create contract, when the parties show that the agreement contained clause as to consideration. Consideration is one of the essential elements of a valid contract. The requirement of consideration stems from the policy of extending the arm of the law to the enforcement of mutual promises of parties. A mere promise is not enforceable at law. Consideration is the price for which the promise of the other contracting party is bought. Nevertheless, this price need not be in terms of money. If the promise is not supported by consideration, the promise will be nudum pactum (a bare promise) and is not enforceable at law. Furthermore, the consideration must be real and lawful. The test of contractual intention is objectivity, not subjectivity. The deciding factor is not what the parties had in mind, but what a reasonable man would think, in the circumstances, their intention to be.

Prior to this in *Banwari Lal v. Sukhdarshan Dayal*, the case was about a plot that was reserved for dharmashala was sold to one Manohari Devi who in turn sold to defendant. Defendant constructed a wall around the plot. Plaintiff then filed a permanent injunction that the plot was reserved for dharmashala and hence should be restored. But the court held that sufficient consideration was paid showed they had intention to sell to any one and not construct dharmashala. It was a contract. This case shows that consideration plays a vital role to conclude

whether the parties intended to contract or not. It has been pointed out that consideration brings out the idea of reciprocity as the distinguishing mark of English in terms of the obligatory nature of promise. The doctrine is supposed to identify the intention of the parties as to their desire to make the agreement legally enforceable. It has been to its reiterating relevance that the doctrine of consideration serves as a safeguard against possibilities where the parties may accidentally bind themselves on impulse.

*Commissioner of Wealth Tax, Bhopal versus Abdul Hussain Mulla* in this case Abdul Hussain Mulla Muhammad Ali advanced a loan of Rs 4 lacs to Faizullahbhai, Mandlawala, Sidhpur. both of them were partners of a firm called Rising Sun flour and oil Mills at Ujjain. the borrower employed the sum as part of his capital in the firm. Wealth tax, as the name suggests, was the tax on The Wealth of the person. A loan does not lower the wealth of a person because the loaned money would be returned. The tax payer raised the contention that the parties did not intend to create legal relations, thus, there was no legal obligation to pay back the Debt or for him to enforce it. The Supreme Court fully enclosed the British judgment that a valid contract may be set aside on the grounds that the parties did not intend to create legal relations. However, it did not recognise this case as qualifying. The court observed

*“The contention has, no doubt, its possibilities. But where, as here, the tax implications of large financial obligations are sought to be put an end to, the burden is heavy on the assessee to establish that what would otherwise be the incidents of the transaction were excluded from contemplation by the parties. Here, one partner has lent a large sum to the other to be utilised as capital in the partnership venture. the transaction is in the context of a commercial venture. The presumption is that legal obligations are intended.”*

**The issue on this point was first brought out before a court**

*In Balfour v/s Balfour (1919) 2 K.B.571*

The case was between a husband and wife, where the husband was in Ceylon and the wife in England. The wife was claiming money the husband had promised for her support. Husband had failed to pay the promised amount to his wife every month, during the period of his stay abroad. The wife had lost the case for the recovery of the amount from her husband. Two judges ruled

that there was no consideration in the agreement it was held to be in the nature of a domestic agreement, sans(without) intention to create any legal obligation.

It may be mentioned to clear the point that there is an usual presumption that all business agreements are entered into with the intension of creating legal consequences, and that all the social and domestic agreements are generally entered into without the intension of creating a legal relationship unless expressly stated or established otherwise with reference to the facts of the case.

*First case in business context: In [Rose and Frank co.V/S J.R Crompton Ltd.(1923)2 KB 261]*

The parties in this case manufacturer and distributors make an agreement document setting on several restraints on buying, selling and territories for operations. The last clause of the document provided “it will be carried through by each of three parties with mutual loyalty and friendly co-operation. This is hereinafter referred to as the “honorable pledge” clause. A dispute arose between the parties and the contention was raised that the parties did not intend to create legal relationship.

Scruton, LJ, at the court of appeal, stated: Now it is quite possible for parties to come to an agreement by accepting a proposal with the result that the agreement concluded does not give rise to legal relations. The reason of this is that the parties do not intend that their agreement shall give rise to legal relations. This intention may be implied from the subject matter of the agreement, but it may also be expressed by the parties. In social and family relations such an intention is readily implied, while in business matters the opposite result would ordinarily follow. But I can see no reason why, even in business matters, the parties should not intend to rely on each other’s good faith and honour, and to exclude all idea of setting disputes by any outside intervention, with the accompanying necessity of expressing themselves so precisely that outsiders may have no difficulty in understanding what they mean. If they clearly express such an intention, I can see no reason in public policy why effect should not be given to their intention.

The assumption in the case of business relations is that the parties intend to create legal relations. However, the parties can exclude this by specifically providing for it.

*Case-jones V/S Vernon's pools ltd (1938) 2All E.R.626.*

In this case one of the clauses in the agreement document had provided that it "Shall not give rise to any legal relationships or be legally enforceable, but binding in honor only".

Take example of another category of agreement in which damages allowed on the basis of intention to create legal obligation

*parker V/S clark(1960) 1W.L.R 286* An old couple(Mr and Mrs clark) had promised to her niece and her husband(Mrs and Parker) through correspondence that if the later would sell their cottage and start living with the former and share their household and other expenses, the former would have a portion of his estate in his will.

Mrs and Mr parker in compliance of the request sold their property and started living with them. But after sometime the two couples quarreled and the old couple repudiated the agreement and asked the young couple to leave the house and stay somewhere else. The young couple won the case for breach of promise by the old couple and could claim damages from the old couple, as aforementioned.

*Jones V/S Padmaavatan (1969)* In this case mother pressurized her daughter to leave service, to take legal education in England and settle in Trinidad with her and undertook to foot the expenses. The mother bought a house in England, part of which was used by daughter and rest was rented out. The daughter couldn't complete her five years education and also got married. Differences arose between the mother and daughter and the mother stopped making payment and also commenced legal proceedings to evict the daughter from her house.

It was held that there was no intention of creating a contract and thus the mother was not bound by the assurances to daughter.

There are a few concept of intention to create legal relations. Intention to create legal relations also means an intention to be serious about agreement significance. The contracting parties mind will be obvious to enter a serious contract

When two parties decided to enter in the environment of a contract, their mind will understand the contents of the contracts. This is due to their 'intention' to be consenting mind which both of the parties have to agree. If there is no agreement by both of the parties, it may make the contract being a void agreement. Thus, both of the contracting parties will enable to be serious into the contract.

b) If there is no intention to create legal relations the contract would not be enforceable, legal and binding

Intention to create a legal relation is one of the essential elements of contract. So, if there is no intention to create a legal relation, the contract can be assumed as a not legal. Due to that, the contract may not being enforceable because there is no intention to create legal relations at the beginning which not making contracting parties to be legally binding.

c) Without intention to create legal relations, the parties cannot sue each other

With no intention to create legal relations, it may cause the contracting parties are not being legally binding and this circumstances may cause the contract is enforceable. Therefore, when the contract is enforceable, the contracting parties cannot sue each other and this will spoil their business crisis. This will make the contracting parties hard to enquire their justice.

d) Without intention to create legal relations the contract may become a mere promise

In addition, with no intention to create legal relations, it will make any contract to become a mere promise. Mere promises simply like a simple promise arise when there is no intention to create legal relations. Based on the case of studies, the situation of mere promises can be seen when Nathan, the Comfortable Furniture Sdn Bhd salesman have no intention to create legal relations. He did not accept cash deposit from Mr John to obey the company policy. When the mere promise occurs, the salesman still can sell the dining set to other people because they is no legal contract between Nathan and Mr john.

e) Without intention to create legal relations the contract may lack the binding effect

Besides that, when there is no intention to create legal relations, it will make the contract or agreement become less powerful due to whether one or both of the parties does not have a consent mind. So, if the contract lack of binding effect, it will cause the difficulty to the party involved in future.

Domestic and social agreements of intention to create legal relations can be broken down into three groups which are firstly commercial or business relations, secondly social friend's relations and thirdly family or domestic relations.

#### a) Commercial or business relations

In term of general rules of commercial or business relations, there is a presumption or intention to be legally binding. Otherwise in term of exception the presumption is rebuttable.

Case example: *Kleinwort Benson Ltd V Malaysia Mining Corporation Bhd in year 1989*

The case shows the letters of comfort. In this case, the plaintiff (bank) agreed loan to MMC Metals, subsidiary of MMC. The bank asked MMC to guarantee loan. MMC said not policy to guarantee loans to subsides offered letter of comfort stating: "It is our policy to ensure that the business of MMC (Metals) is at all times in a position to meet its liabilities under the arrangements". The bank accepted but charged higher rate of interest and the market collapsed and MMC went into liquidation. The plaintiffs tried to claim balance from MMC. First instance the court found in favour of plaintiff, relying heavily on Skyways (1964) ruling overturned on appeal and the judge said Skyways case not was about promise supported by consideration so not applicable here. Hence, ruled no intention to create legally binding agreement statement was not meant to act as guarantee, stating on current position, not future intention.

#### b) Social friend's relations

In term of general rules of social friend's relations, there is no presumption to be legally binding. Otherwise, in term of exception the presumption is rebuttable.

*Simpkins V Pays*

The case shows mutuality. In this case the defendant, her granddaughter and the plaintiff (paying lodger) regularly took part in newspaper competition. All contributed but entered in defendant's name. There is no set of arrangement that state payment of postage etc. When entry of the competition is successful, defendant refused to share with plaintiff. The plaintiff sued for his share. Court ruled legally binding relationship as sufficient mutuality in the arrangements between parties.

#### c) Family or domestic relations

In term of general rules of family or domestic relations, there is no presumption to be legally binding. Otherwise, in term of exception the presumption is rebuttable.

### **CONSIDERATION**

Consideration is one of the essential elements of contract. There are many definition of consideration. A promise made without consideration is merely gratuitous and, however sacred and binding in honour it may be, it cannot create a legal obligation. An analysis of any contract shows that it consists of two parts: (i) promise and (ii) consideration for the promise. A person makes a promise to do or abstain from doing something as a return or equivalent of some loss, damage, or inconvenience that may have been occasioned to the other party in respect of the promise. The benefit so received and the loss, damage or inconvenience so caused is considered in law as the consideration for the promise. Hence, generally speaking, a contract cannot be thought of without consideration; however, there are some exceptions to this general rule. There are a number of provisions concerning consideration in the Indian Contract Act, such as, sections 2(d), 10,23,24, 25,148, and 185.

At first, consideration can be defined as something that is worth and have value such as an item or services. Besides that, based on the case of *Currie V Misa*, the classic definition of consideration can be describe that a consideration is a worth consideration which may involve right, interest, profit or benefit of one party which come from any forbearance, detriment, loss or responsibilities occurred and after being experience of the promisee. Consideration includes of

executory, executed except for past. Apart from that, consideration in contract is executory when whether works has not been completed, but which needs to be completed in future. Next, consideration in contract is executed when works have been completed. Furthermore, past consideration refers to being past at a time before the making of a promise. Consideration only amounts to past consideration if it was performed before the return promise was made for example before the contract was formed. Consideration occurs as the requirements in order to enable the party to enforce a promise.

### ***ESSENTIALS OF CONSIDERATION***

#### **i. Consideration can be past, executory and executed**

Consideration provided for a promise must be done in relation to that promise. If something has already been completed and the promise comes after, this is a past consideration. Executory consideration consists of two promises and executed consideration consists of one promise followed by some action.

#### **ii. Consideration must move from the promisor**

Consideration must be provided by promisee in order for her or him to be able to enforce promise. Thus, party who has not provided consideration for promise cannot enforce promise and it is only the party who has “paid” for promise who can enforce it.

Case example: *Tweddle V Atkinson* in year 1861

John Tweddle promised William Guy that he would pay a sum of money to the child of William Guy, and likewise William Guy promised John Tweddle that he would pay a sum of money to the child of John Tweddle, upon the marriage of the two children to each other. However, William Guy failed to pay the son of John Tweddle, who then sued his executors for the amount promised. It was held that the son could not enforce the promise made to his father, as he himself had not actually given consideration for it – it was his father who had done so instead. This particular rule of consideration forms the basis of the doctrine of privity of a contract, that is, only a party to a contract is permitted to sue upon that contract’s terms. Therefore consideration

from the promisee was indulgent of the claim. Although consideration must move from the promisee, it does not necessarily have to move to the promisor. The promisee may provide consideration to a third party, if this is agreed at the time the parties contracted.

iii. Consideration must have economic value

Nevertheless, consideration must have some economic or material value even if negligible. Consideration cannot consist solely in sentimental or otherwise emotional value. For example following someone wishes or promising not to keep boring a person with complaints.

Case example: *White V. Bluett* in year 1853

A son sued his father's executors, alleging that the father had promised to pay him some money if he would cease, as the father alleged the son had done, complaining to him that he had been unfairly treated. This promise was too vague to be a "real" consideration.

This explains where a son's promise to stop complaining to his father about the distribution of the father's property was held to be incapable of amounting to consideration.

iv. Consideration cannot be the past

Consideration must be given in return for; such as in the situation of must be, to some extent, motivated by, promise or act of other party. For example, there must be fairly direct co-relation between consideration and promise or action. Something only done for reason other than promise will not be valid consideration for promise.

Case example: *Roscorla V Thomas* in year 1842

Roscorla and Thomas contracted to buy a horse for £30. After the sale, Thomas promised Roscorla that the horse was sound; the horse turned out to be vicious. It was held that Roscorla could not enforce the promise, as the consideration given for entering into the contract to buy the horse had been completed by the time the promise was made; in a sense, the consideration was "used up".

Case example: *ReMcardle* in year 1951

This case is the archetypal example of a past benefit being unacceptable as consideration in a contract. The occupants of a house carried out certain improvements during their tenancy, and were offered payment in recompense by the owner. However, the owner died before doing so, and his representatives refused to honour the promise. The courts supported the owner's representatives, because the tenants had not provided good consideration. Note that in this case the tenants' work was carried out at their own behest, and not at the request of the owner. Had the owner explicitly requested the tenants to do the work, and then offered payment, the court may have been able to use the doctrine of Implicit Assumpsit to incorporate the past work into the agreement, and thereby deem it consideration.

Case example: *Lampleigh V Braithwait* in year 1615

This case introduced the doctrine of Implicit Assumpsit, which states that although it is a strong principle of English law that a past benefit cannot be invoked as consideration to support a future contract, this principle may not be operative when the past benefit accrued at the beneficiary's request, and with an understanding given that the benefit would be reward in the future. Braithwaite was convicted of an unlawful killing. In desperation he asked Lampleigh to petition the King for a pardon. This was successful, and Braithwaite offered Lampleigh £100. However, when Lampleigh tried to claim, Braithwaite refused. His defense claimed Lampleigh had offered no consideration, so the agreement was not binding. The court ruled that in cases of this sort, where a past benefit was at the request of the beneficiary and where reward was expected, the past consideration could be 'assumed' into the agreement.

Case example: *Eastwood V Kenyon* in year 1840

Mr. Eastwood brought up Sarah, the daughter of one of his friends, who died leaving Sarah sole heiress to his fortune. Mr. Eastwood had few resources and had to borrow a large sum of money to educate Sarah. When Sarah came of age, she promised to reimburse the amount. After her marriage, her husband made the same promise to Mr. Eastwood.

***Exceptions to the rule 'agreement without consideration is void':***

The general rule of law is that an agreement made without consideration is void. Nevertheless, there are a few exceptional cases where a contract, even though without consideration, is enforceable. They are as follows:

1. Where an agreement is expressed in writing and registered under the law for the time being in force for the registration of documents, and is made on account of natural love and affection between parties standing in a near relation to each other [S. 25 (i)];
2. Where an agreement is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do [S. 25 (2)];
3. Where an agreement is a promise, made in writing and signed by the person to be charged therewith, or by his agent generally or specially authorized in that behalf, to pay wholly or in part a debt of which the creditor might have enforced payment but for the law for the limitation of suits [S. 25 (3)];
4. Cases of gift (Explanation to S. 25);
5. Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit. (S. 63, ICA);
6. Consideration is not necessary to effect bailment (S. 148, ICA).
7. No consideration is required to create an agency (S. 185, ICA).