ENFORCING PROMISES

Consideration and Intention in the Law of Contract

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Introduction

The doctrine of consideration is one of the most fiercely debated aspects of the law of contract in Common Law jurisdictions. Consideration emerged during the sixteenth century as an element of actions in assumpsit (breach of promise or undertaking).[1] It has suffered criticism from judges,[2] academics[3] and the English Law Revision Committee[4] alike. But despite its controversial status, it remains an essential requirement for the formation of contracts not in deed form.[5] Through the doctrine of consideration, contract is largely restricted to the realm of bargains involving an exchange of value between two parties. This is not the only possible approach to contract; in fact, it is unique to Common Law systems. Civil law jurisdictions and the mixed legal systems of Scotland and South Africa do not require consideration for contract formation.

The debate surrounding the doctrine of consideration is part of a larger and more fundamental question: which promises should the law enforce? The answer to that question depends on one's view as to why the law of contract exists, and what it should aim to achieve. An understanding of contract theory is therefore crucial to any evaluation of the consideration requirement. The purpose of contract law generally and, more specifically, the doctrine of consideration, is discussed in chapter one of this paper.

Chapter two addresses the practical implications of the consideration requirement. Perhaps the most easily discernable consequence of the requirement is that purely gratuitous promises are unenforceable unless contained in a deed. This in itself is hugely controversial; some academics argue that all seriously intended undertakings should be legally binding.[6] However, the effects of the doctrine of consideration are not confined to promises ordinarily understood as gratuitous. Some promises commonly made in commercial situations, such as promises to keep an offer open, or to unilaterally alter one's rights or obligations under an existing contract, do not usually involve consideration in the traditional sense.

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[1] Val D Ricks "The Sophisticated Doctrine of Consideration" (2000) 9 GMLR 99 at 102.
[2] E.g. Lord Mansfield (see *Pillans & Rose v Van Mierop & Hopkins* (1765) 3 Burr 1663) and Lord Wright (see "Ought the Doctrine of Consideration to be Abolished from the Common Law ?" (1936) 49 Harv LR 1225).
[3] E.g. Charles Fried *Contract as Promise: A Theory of Contractual Obligation* (Harvard University Press, Cambridge, 1981); T M Scanlon "Promises and Contracts" in Peter Benson (ed) *The Theory of Contract Law: New Essays* (Cambridge University Press, Cambridge, 2001).
[4] English Law Revision Committee, *The Statute of Frauds and the Doctrine of Consideration* (Cmd5449, 1937) at [24], published in (1937) 15 Can Bar Rev 585.
[5] In New Zealand, the requirements for a deed are set out in s 9 of the Property Law Act 2007. See Chapter Two, Part I(2) for further detail.
[6] E.g. Fried, above n 3.

In order to understand the true impact of the consideration requirement, it is necessary to place consideration in its wider legal context. To that end, chapter two discusses the use of deeds to render gratuitous promises enforceable, and the application of equitable estoppel to provide relief to promisees who have relied on non-binding promises. Chapter three then evaluates the Scottish approach to enforcing promises, in order to demonstrate the feasibility of having a framework of voluntary obligations which does not include a consideration requirement.

The final chapter of this paper recommends the enforcement of all promises made in a manner evidencing intention to be legally bound, regardless of the presence or absence of consideration, on the basis that such promises induce the promisee to reasonably expect performance or legal redress. A strict consideration requirement unjustifiably limits the law of contract to promises given for value, which can frustrate the legitimate intentions and expectations of the parties. Whether a theoretical or a pragmatic analysis is adopted, the Common Law's insistence on consideration as a pre-requisite for contract formation requires reform.

Chapter One: Consideration and Contract Theory

PART I: A THEORY OF CONTRACT

Because any evaluation of which promises ought to be enforced is influenced by one's assumptions about the purpose of contract law, it is necessary to briefly explain the theory of contract on which the remainder of this paper will proceed. It must be emphasised that the following discussion is not intended to be a comprehensive analysis of contract theories.

1. Promise

A promise is the communication of an intention to undertake or assume an obligation.[1] This paper will analyse contract in terms of promise.[2] That is not to say that all promises should be legally enforceable. A contract involves a promise or promises made in a manner which the law recognises as sufficient to undertake a *legally binding* obligation.[3] It must also be stressed that it is not suggested contracts ought to be enforced *simply because* they involve promises. The mere act of promising may create a *moral* obligation to keep the promise,[4] but some further justification is required for why the promise ought to be enforceable as a contract.[5]

2. Reasonable Expectation

One theory, propounded by Adam Smith and endorsed by many commentators and judges, is that contracts should be enforced because they induce reasonable expectations.[6] This theory is consistent with the remedies for breach of contract. The

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[1] Stephen A Smith *Contract Theory* (Oxford University Press, New York, 2004) at 57; Brian Coote "The Essence of Contract: Part II" (1988) 1 JCL 183 at 192.

[2] It is important to note that the view that contract is based on promise, while being the orthodox approach (Smith, *ibid,* at 56), is by no means universally accepted. It has been suggested that contractual obligations are imposed to prevent us from harming others whom we induce to rely on us (see, for example, Lon Fuller and William Perdue "The Reliance Interest in Contract Damages" (1936) 46 Yale L J 52), or that a contract is a transfer of rights (Peter Benson, "The Unity of Contract Law" in Peter Benson (ed) *The Theory of Contract Law: New Essays* (Cambridge University Press, Cambridge, 2001)).

[3] Coote "The Essence of Contract: Part II", above n 1, at 195. This is the approach adopted in the Restatement (Second) of Contracts, § 1, which defines a contract as "a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty."

[4] Because the promisor chooses to invoke a social convention the function of which is to give the promisee an expectation of performance (Charles Fried *Contract as Promise: A Theory of Contractual Obligation* (Harvard University Press, Cambridge, 1981) at 16).

[5] T M Scanlon "Promises and Contracts" in Peter Benson (ed) *The Theory of Contract Law: New Essays* (Cambridge University Press, Cambridge, 2001) at 99-100.

[6] Brian Coote "The Essence of Contract: Part I" (1988) 1 JCL 91 at 103-104; Johan Steyn "Contract law: fulfilling the reasonable expectations of honest men" (1997) 113 LQR 433; Joseph M Perillo &

ordinary remedy is damages calculated according to the expectation measure,[7] or specific performance if monetary damages are inadequate.[8] Essentially, the promisor must perform the promise or compensate the promisee by paying the monetary equivalent of performance.[9] Thus contract law protects the promisee's reasonable expectation of performance. Expectation is objectively assessed.[10] The court will consider what a reasonable person in the promisee's position would have expected to obtain as a result of the promise. A promisor is not required to fulfill unreasonable expectations.

One possible justification for protecting reasonable expectations is psychological. The promisor, by making the promise, gives the promisee hope that it will be performed. If the promisor fails to perform, it causes a sense of injury or deprivation in the promisee.[11] While this reasoning may be consistent with our sense of morality, it provides no basis for turning a moral obligation to perform into a legal one. There are many circumstances in which someone causes disappointment to another, but the law does not (and should not) intervene.[12] For example, if I promise to meet you for coffee, you may have a reasonable expectation that I will do so. My failure to show up may cause you a sense of deprivation or injury. But it would be absurd if casual, social promises of this nature were legally binding.

The better view is that the loss caused to the promisee by the promisor's breach is not merely psychological. When the promisor undertakes a legal obligation, this confers on the promisee a right to have the promise performed.[13] In economic terms, the promisee has gained an asset in the form of a guarantee of performance or legal redress. If the promise is not performed, the promisee is deprived of a real right and should be compensated for that loss.[14] However, this proposition begs the question of how to determine when a promisor undertakes a *legal* obligation, as opposed to a moral one. A promise which is only morally binding cannot give the promisee a legally enforceable right to performance or compensation.

Helen Hadjiyannakis Bender *Corbin on Contracts, Vol 2: Formation of Contract* (Revised ed, West Publishing Co, St. Paul Minnesota, 1995) at 20; Roscoe Pound "Promise or Bargain?" (1958-1959) 33 Tul L Rev 455 at 471.

[7] *Coxhead v Newmans Tours* (1993) 6 TCLR 1 at 13 (CA).

[8] *Attorney-General for England and Wales v R* [2002] 2 NZLR 91 at [94].

[9] Smith, above n 1, at 59-60.

[10] Steyn, above n 6, at 434.

[11] Fuller and Perdue, above n 2, at 57.

[12] Coote, "The Essence of Contract: Part I" above n 6, at 104-105.

[13] Smith, above n 1, at 72.

[14] Note that this is different to the transfer theory advanced by Benson (above n 2, at 132-137), which asserts that when a contract is made the promisor transfers to the promisee a proprietary right in the actual thing promised. This theory has been convincingly refuted by Smith (above n 1, at 101-102). Except in cases of transfers of specific objects, the contracting party does not own the 'thing' to be transferred prior to contracting.

Lord Steyn, writing extra-judicially, has remarked that giving effect to the reasonable expectations of the parties is "the central objective of the law of contract."[15] While protecting the promisee's reasonable expectations is an important *objective*, the mere fact that a promise produces corresponding expectations does not explain why it should be enforceable as a contract. If reasonable expectation was the sole basis of contract, then virtually all promises would be contracts. To the contrary, many promises give rise to a reasonable expectation of performance, but neither party expects or intends that they should be legally binding.

3. Intention

Fried argues that it is necessary to enforce promises because "respect for others as free and rational requires taking seriously their capacity to determine their own values."[16] If promisors are permitted to go back on their promises without being held accountable, their choice to invoke the social convention of promising is not taken seriously. As autonomous individuals, we should be entitled to undertake binding obligations if we desire. This is a variation on the will theory, which holds that contracts are inherently worthy of respect because they are an expression of human will or intention.[17]

There are several problems with this theory. First, it still fails to explain why only some promises are legally binding. If promises were enforced simply because they reflect the free and rational choices of autonomous individuals, then all promises made free of duress or undue influence would be enforceable. What distinguishes contractual obligations from mere promises is that the parties intend not only that the promise be performed, but that if it is not, the promisee can obtain legal redress. Thus, to form a contract, the promisor must intend to undertake a *legal* obligation.[18] It would generally be unfair to force a promisor to perform or compensate the promisee for a casual promise which was never intended or understood to be legally binding.

However, a theory which justifies contractual obligation solely on the basis that it reflects the intention of the promisor to enter into a legal obligation is also

[15] Steyn, above n 6, at 434.
[16] Fried, above n 4, at 20.
[17] Coote "The Essence of Contract: Part I" above n 6, at 99.
[18] See *Balfour v Balfour* [1919] 2 KB 571, where the English Court of Appeal held that the mere existence of an agreement between husband and wife, in the form of a promise supported by consideration, will not ordinarily create a contract because the parties "did not intend that [the promise] should be attended by legal consequences" (per Atkin LJ at 578-579).

inadequate, as it entails a subjective theory of intent.[19] The result would be an entirely one-sided theory of individual autonomy.[20] The promisor could outwardly manifest an intention to be legally bound, thereby inducing the promisee to reasonably expect performance or a legal remedy, but the promisor would not be bound if that was not his subjective intention. The promisee would have no way of knowing whether he had a right to performance or not. This is why intention to be legally bound must be ascertained objectively from conduct of the parties.[21] Whether a promisor subjectively intended to be bound is not pertinent, just as it is irrelevant whether the promisee subjectively expected the promisor to perform.

4. Intention and Corresponding Expectation

The preceding discussion has shown that contract cannot be justified solely on the basis of the promisor's exercise of will, nor solely on basis of the promisee's reasonable expectations. It is submitted that the *interaction* of the intention of the promisor and the expectation of the promisee converts a promise into a contractual obligation. Both must relate to the legal enforceability of the promise as opposed to its moral force. The promisor must conduct himself in a manner that would lead a reasonable person in the promisee's position to believe that he intended to be legally bound. The promise will then have contractual force *because* it would induce a reasonable promisee to expect performance or equivalent compensation. In such circumstances, it would be unfair to permit the promisor to renege. So, while the central *objective* of contract law is to protect the reasonable expectations of the promisee, the promisee's expectations will only be 'reasonable' if the promisor has induced the promisee to believe that he is undertaking a legal obligation. The promisor's objectively manifested intention corresponds with the promisee's reasonable expectation.

In an executory bilateral contract, each party will both intend to undertake a legal obligation and reasonably expect that the other party will perform his obligation. But this theory of contractual obligations is equally applicable to unilateral and gratuitous promises.[22] In such cases only the promisor will have an intention to

[19] Michael J Trebilcock *The Limits of Freedom of Contract* (Harvard University Press, Cambridge, 1993) at 165.
[20] *Ibid.*
[21] *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG (UK Production)* [2010] UKSC 14, [2010] 1 WLR 753 at [45]; *Edmonds v Lawson & Anor* [2000] All ER 31 at [21]; *Chas S Luney Ltd v State Bank of South Australia* HC Christchurch CP 49-93, 9 November 1994 at 12; *Pagnan SpA v Feed Products Ltd* [1987] 2 Lloyd's Rep 601 at 610; *Albert v Motor Insurers Bureau* [1972] AC 301 at 339.
[22] At present such promises are not generally enforceable at Common Law (unless contained in a deed or amounting to a unilateral contract), because of the consideration requirement, which is discussed in Part II of this chapter.

undertake a legal obligation, and only the promisee will have a reasonable expectation of performance. Those promises which are currently enforced as unilateral contracts would also fall within this category.

This theory explains why only promises intended to be legally binding are enforced, while also accounting for the fact that intention must be objectively assessed. It achieves the optimum balance between the interests of the parties, by ensuring that promisees are not deprived of reasonably expected benefits, while also protecting promisors from liability to compensate for illegitimate expectations.

5. Conclusion

The law should recognise a promise as a contract when a reasonable person in the promisee's position would expect performance or equivalent compensation. This will be so when the promisor has outwardly manifested an intention to undertake a legal obligation. To the extent that the law imposes further restrictions on the enforceability of promises, the freedom of autonomous individuals to contract is restricted. The intentions of the parties will be frustrated if what they perceive to be a legally binding obligation is unenforceable. The imposition of any additional requirement for contract formation must therefore have a strong justification to outweigh its potentially adverse effects.

PART II: THE DOCTRINE OF CONSIDERATION

1. Defining Consideration

For a promise to be enforceable as a contract in Common Law jurisdictions, it must either be contained in a deed or supported by consideration.[23] Lord Dunedin defined consideration in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*:[24]

> 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.

This notion of consideration as the price paid for a promise has been adopted in New Zealand.[25] Consideration may take the form of a benefit conferred on the promisor, a detriment incurred by the promisee at the promisor's request, or a promise

[23] *Moschi v Lep Air Services Ltd* [1973] AC 331 at 346.
[24] *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847 at 855.
[25] *Rothmans of Paul Mall (NZ) Ltd v Attorney-General* [1991] 2 NZLR 523 at 328; *Attorney-General for England and Wales v R*, above n 8, at [39].

to confer a benefit or suffer a detriment.[26] For example, in an ordinary contract of sale, the consideration given for the promise to transfer title to the property can be either a promise to pay the purchase price, or actual payment. The consideration must be given in response to the promise,[27] or, if given prior to the promise, at the promisor's request and in such a manner that it can be reasonably understood as forming part of the same transaction.[28] A new promise that is not supported by new consideration is unenforceable; past consideration is insufficient.[29]

Through the doctrine of consideration, the Common Law purportedly requires a "mutual exchange"[30] to form a contract. This reflects the fact that the Common Law models its concept of contract on commercial transactions, in contrast to legal systems such as France and Scotland, which have a broader understanding of the place of contract in society.[31] The Common Law courts will not, however, inquire into the adequacy of the consideration.[32] The 'exchange' need not be of equivalents. In *Mountford v Scott*,[33] an option to purchase land granted in return for payment of £1 was held to be binding, although "the £1 consideration for Mr. Scott's option was merely a token payment to clinch the bargain and did not in any real sense represent a purchase price for the grant of the option."[34] The New Zealand Court of Appeal in *Melmerley Investments Ltd v McGarry* confirmed that "a Court is concerned only with the presence of consideration and does not make an assessment of the comparative value of the acts or promises of the parties towards one another."[35] Nominal consideration is sufficient.[36]

2. The Purpose of Consideration

a) The Bargain Theory

The orthodox view is that the consideration requirement recognises that the law of contract in Common Law jurisdictions is only concerned with bargains.[37] The

[26] *Attorney-General for England and Wales v R,* above n 8, at [38], [40].
[27] *Ibid* at [40].
[28] *Pao On v Lau Yiu-Long* [1979] HKLR 225 at 234; *Attorney-General for England and Wales v R*, above n 8, at [40]; *Re Peter Barnett Ltd* HC Wanganui CP7/98, 24 June 1999 at [16].
[29] *Bob Guiness v Salomonsen* [1948] 2 KB 42.
[30] *Attorney-General for England and Wales v R,* above n 8, at [38].
[31] See Donald Harris and Dennis Tallon (eds) *Contract Law Today: Anglo-French Comparisons* (Clarendon Press, Oxford, 1989) at 386 (on France) and Chapter 3 of this paper (on Scotland).
[32] *Sturlyn v Albany* (1587) 1 Cro Eliz 67 at 68: "when a thing is done, be it never so small, this is sufficient consideration to ground an action." In NZ, see *Re Peter Barnett Ltd,* above n 28, at [13].
[33] *Mountford v Scott* [1975] Ch 258.
[34] *Ibid* at 261.
[35] *Melmerley Investments Ltd v McGarry* CA141/01, 6 November 2001 at [21].
[36] *Ibid.*
[37] See, for example, K O Shatwell "The Doctrine of Consideration in the Modern Law" (1954) 1 Syd LR 289; JF Burrows, Jeremy Finn and Stephen MD Todd, *The Law of Contract in New Zealand* (2nd

bargain theory is particularly prevalent in the United States, where the Restatement (Second) of Contracts specifies that consideration must be "bargained for", that is, "sought by the promisor in exchange for his promise and… given by the promisee in exchange for that promise."[38] The consideration and the promise must be mutually inducing.[39]

Prima facie, it might appear that the bargain theory is an accurate description of our current law. But closer inspection reveals that our law of contract is not concerned only with bargains. Some contracts that are generally accepted as enforceable do not involve any true exchange or mutual inducement. This point is illustrated by several examples. The first is the unilateral contract. Although the act which constitutes consideration is requested by the promisor, the promise is made with no guarantee that the requested act will be performed. It cannot be said that the promise is made in exchange for the act or is induced by it.[40] The promise is made in the *hope* that the act will be performed, but this is different to being induced by the performance of the act itself.

Second, the sufficiency of nominal consideration is also inconsistent with the bargain theory. In a strict sense, something is still given for the promise. But again, the promise is not induced by the exchange of nominal consideration. If the law permitted it, the promise would be made without any consideration being given in return. The consideration is not 'bargained for' in any substantive sense;[41] it is simply a token payment by the promisee to make what is essentially a gratuitous promise enforceable.[42] Benson argues that the nominal consideration rule is a natural consequence of the reluctance of the courts to inquire into the adequacy of consideration.[43] That may be true, but the *practical result* of the sufficiency of nominal consideration is that the courts do not insist on a substantive bargain. If the basis of contract is bargain, it is artificial to include in that category an otherwise gratuitous promise made enforceable by the payment of nominal consideration. Consequently, any potential justification for restricting contract to bargains is watered down by the difficulty of adhering to the bargain theory in practice.

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ed, LexisNexis NZ, Wellington, 2002) at 96. For an application of the bargain theory of consideration by the New Zealand Court of Appeal, see *Chambers v Commissioner of Stamp Duties* [1943] NZLR 504 at 527.

[38] Restatement (Second) of Contracts, § 71.

[39] *Ibid,* § 71, comment b.

[40] Smith, above n 1, at 229.

[41] Bruce MacDougall "Consideration and Estoppel: Problem and Panacea" (1992) 15 Dalhousie LJ 265 at 268.

[42] English Law Revision Committee, *The Statute of Frauds and the Doctrine of Consideration* (Cmd5449, 1937) at [21], as published in (1937) 15 Can Bar Rev 585.

[43] Benson, above n 2, at 167.

Third, the fact that gratuitous promises are enforceable in New Zealand if executed in deed form further demonstrates the inadequacy of the bargain theory.[44] If the law of contract was only concerned with bargains, gratuitous promises would never be enforceable. The recognition of binding gratuitous promises in deed form suggests that the concern with gratuitous promises is not that they involve no exchange, but that they require certain safeguards to ensure deliberation and intention to be bound.

Accordingly, the bargain theory is inconsistent with the current law of contract in New Zealand. But the more important question for present purposes is whether the law of contract *should* be restricted to bargains. What, then, are the possible justifications for the bargain theory? One argument is that, in economic terms, promises which do not involve any exchange are not worth enforcing. Gratuitous promises simply redistribute the wealth of society rather than increasing it.[45] Fuller states, "[w]hile an exchange of goods is a transaction which conduces to the production of wealth and the division of labor, a gift is, in Bufnoir's words, a 'sterile transmission.'"[46] Most commentators now agree that this is not the case.[47] When someone makes a gratuitous promise, they must value what they are getting (the satisfaction of benefiting another) more than what they are giving up. Otherwise they would not make the promise.[48] Therefore gratuitous promises, like bargains, cause a net increase in social welfare.[49] Both parties are better off after the promise is made.[50] But the transaction is not a bargain, because the benefit to the promisor is not conferred on him by the promisee in exchange for the promise.

This conclusion is reinforced by the fact that if a promise to make a future gift is binding, it is more valuable to the promisee and facilitates beneficial reliance.[51] Imagine, for example, that a grandfather promises to pay his grandson a $200 allowance per week while he studies at university. If the promise is unenforceable, the grandson has no guarantee that he will actually receive the money. He may be reluctant to enrol at university in case the payments should cease and he should end up in economic strife. If the grandfather can make his promise legally binding, it will be worth more to the grandson. He will not hesitate to go to university, because his

[44] Property Law Act 2007, s 9.
[45] Smith, above n 1, at 222.
[46] Lon Fuller "Consideration and Form" 41 Colum L Rev 799 (1941) at 815.
[47] Smith, above n 1, at 222-223; Melvin Aron Eisenberg "The Principles of Consideration" in Richard Craswell & Alan Schwartz (eds) *Foundations of Contract Law* (Oxford University Press, Oxford, 1994) at 230; Fried, above n 4, at 37; Perillo and Hadjiyannakis Bender, above n 6, at 16-17.
[48] Richard Posner, "Gratuitous Promises in Law and Economics" (1977) 6 Journal Of Legal Studies 411 at 412.
[49] Perillo and Hadjiyannakis Bender, above n 6, at 16-17; *Ibid*.
[50] Smith, above n 1, at 222-223; Eisenberg, above n 47, at 230.
[51] Posner, above n 48, at 412.

grandfather is more likely to continue making payments, and, if he does not, the grandson will be entitled to legal redress. Permitting promisors to make binding gratuitous promises therefore facilitates future planning. The objection that gratuitous promises are economically 'sterile' is unmeritorious.

Another possible argument in favour of the bargain theory is that gratuitous promises are usually trivial and made in social or domestic contexts.[52] It would not be economically viable for the courts to determine small scale disputes,[53] and family relations may deteriorate if arrangements previously based on trust and mutual benefit were able to be sued upon.[54] However, there are promises not involving bargains which are not trivial and not social or domestic in nature.[55] Conversely, bargains may involve such trivial values that it is not economically beneficial for the courts to enforce them,[56] or may be made in social or family situations.

In any case, where a gratuitous promise is trivial in nature, the promisee is unlikely to seek to enforce it given the high costs of litigation. In addition, it is doubtful that in such cases the promisor will have manifested an intention to be legally bound. The second point is also true of social and domestic arrangements. Even without any consideration requirement, gratuitous promises would only be enforceable if the promisee could show that the promisor manifested an intention to undertake a legal obligation.[57] In light of this, there is no justification for refusing to enforce promises made in a social or domestic setting simply because they do not involve bargains. The argument that enforcing such agreements will diminish their inherent value as arrangements based on trust and shared interest does not apply where it is clear that the parties never viewed the agreement that way in the first place.[58]

Given that gratuitous promises are not economically 'sterile', and trivial or social promises would only be enforceable upon proof of intention to be bound, the bargain theory is inadequate not only to describe our current law, but also as a theory to explain which promises should be enforced as contracts.

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[52] Posner, above n 48, at 417.
[53] *Ibid* at 416-417.
[54] Smith, above n 1, at 214.
[55] See Chapter Two, Part I(1) for some examples.
[56] Posner, above n 48, at 417.
[57] See Chapter 4, Part II(3), for a discussion of how intention to create legal relations can be proved.
[58] Smith, above n 1, at 214-215.

b) Consideration as a Formality

In 1765, Lord Mansfield already viewed consideration as no more than evidence that the parties intended to be bound, and thought it was not necessary in contracts reduced to writing or commercial in nature.[59] This approach was overruled by the House of Lords in *Rann v Hughes*.[60] However, two recent New Zealand Court of Appeal cases suggest a similar view of consideration as a formal requirement. In *Antons Trawling Co Ltd v Smith*, it was stated, "[t]he importance of consideration is as a valuable signal that the parties intend to be bound by their agreement, rather than an end in itself."[61] Similarly, in *Melmerley Investments v McGarry*,[62] the Court reproduced the following passage from *Vantage Navigation Corporation v Suhail and Saud Bahwan Building Materials LLC (The "Alev")* with apparent approval:[63]

> Ultimately the question of consideration is a formality as is the use of a seal or the agreement to give a peppercorn. Now that there is a properly developed doctrine of the avoidance of contracts on the grounds of economic duress, there is no warrant for the Court to fail to recognize the existence of some consideration even though it may be insignificant and even though there may have been no mutual bargain in any realistic use of that phrase.

The Court referred to this quote in the context of finding that nominal consideration is sufficient to support a contract. As discussed above, the sufficiency of nominal consideration (which does not reflect a substantive bargain) indicates that the purpose of consideration is not to ensure that only bargains are enforced as contracts. Nominal consideration is simply a formality.[64] Since the courts do not distinguish between nominal consideration and 'real' consideration (except in the United States),[65] this suggests that the function of consideration generally is simply to act as evidence of intention to be bound. In New Zealand, the enforceability of gratuitous promises contained in a deed under s 9 of the Property Law Act 2007 supports this conclusion. Neither nominal consideration nor deeds fulfill any substantive function,[66] yet both are evidently viewed by the courts and legislature as adequate substitutes for a substantive exchange of value.

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[59] *Pillans v Van Mierop* (1765) 3 Burr 1663 at 1669.
[60] *Rann v Hughes* (1778) 7 TR 350.
[61] *Antons Trawling Co Ltd v Smith* [2003] 2 NZLR 23 at [93].
[62] *Melmerley Investments v McGarry,* above n 35, at [21].
[63] *Vantage Navigation Corporation v Suhail and Saud Bahwan Building Materials LLC (The "Alev")* [1989] 1 Lloyd's LR 139 at 147 per Hobhouse J.
[64] MacDougall, above n 41, at 267-268.
[65] Restatement (Second) of Contracts, § 71, comment b.
[66] Smith, above n 1, at 217.

It must be asked, however, whether consideration actually fulfills a formal function. Legal formalities can serve three functions.[67] First, they may provide evidence of the content of an agreement or promise (the evidentiary function).[68] Second, a formality can act as a cautionary measure.[69] If a promisor is required to do something more than simply make an oral promise (such as signing a document) before he will be bound, it is more likely that he will understand the seriousness of the obligation he is about to undertake. Finally, a formal requirement fulfills a channeling function, by showing that the parties intended the promise or agreement to have legal consequences.[70] In other words, it evidences the intention of the parties to be bound.

Consideration does fulfill the channeling and cautionary functions in some situations. For example, where nominal consideration is provided to make an otherwise gratuitous promise a contract, it shows that the parties intend the promise to be binding. It may also to be cautionary; if the parties have gone through the effort of providing for nominal consideration, they have probably thought about the arrangement more than would be the case if the promise was made impulsively. However, for a number of reasons, the current approach of the courts is incompatible with the theory that the purpose of consideration is entirely formal. First, consideration does not always fulfill a formal function. It does not provide conclusive evidence of intention to be bound; people often exchange informal promises or acts impulsively or without intending to enter into a contract.[71]

Second, consideration is required for all contracts not under seal. But it is not clear that all promises require the protection afforded by formalities. Some already satisfy the functions of form to some extent due to the nature of the promise.[72] For example, a promise made by one commercial party to another is likely to be made with deliberation, often after some negotiation between the parties. In such cases the disadvantages of having a formal requirement, namely the frustration of the parties' intention to be bound if the formal requirement is not complied with (because the parties are not aware of the formal requirements, or an error is made), may outweigh any benefits.[73]

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[67] Fuller, above n 46, at 800-801; Smith, above n 1, at 210.
[68] Fuller, above n 46, at 800; Smith, above n 1, at 210.
[69] *Ibid.*
[70] Fuller, above n 46, at 801; Smith, above n 1, at 210.
[71] Mindy Chen-Wishart "Consideration and Serious Intention" [2009] SJLS 434 at 441. See, for example, *Jones v Padavatton* [1969] 1 WLR 328.
[72] Smith, above n 1, at 211.
[73] Smith, above n 1, at 211.

Finally, if consideration is only relevant as evidence of intention to be bound, other forms of evidence should also suffice. This was recognised by the English Law Revision Committee in its 1937 report, where it recommended that consideration should not be required if the promise is in writing and that amounts to adequate evidence of intent.[74] But this is not reflected in our current law. Contracts for the sale of land are required by statute to be recorded in writing,[75] and yet there is no authority to the effect that they do not require consideration. It would be appropriate, if consideration is abolished as a separate requirement for contract formation, to retain it as one form of evidence that the parties intended to be bound. But any formal function that consideration fulfills cannot explain its application as a necessary requirement for all contracts.

c) The Realist Interpretation

Atiyah suggests that consideration originally developed, and is still best understood, as a requirement that there be a 'reason' to enforce a contract.[76] The problem with this view is that it provides no guidance as to what 'reasons' suffice to enforce a contract, a matter on which judges' opinions legitimately differ. As Smith points out, "[t]he rule's ultimate purpose, in the realist view, is to function as a residual category; it allows judges to rely on reasons that have not been, and in some cases, arguably cannot be, incorporated explicitly into the law."[77] If judges were permitted to enforce whichever promises they deemed worthy of enforcement, the result would be a complete lack of certainty.

In any case, while historically it may be true that consideration developed as a mechanism for requiring a good reason for enforcement,[78] it has now existed for so long that judges are not free to enforce a contract whenever they feel there is good reason to do so. Precedent will often dictate a particular result. If it can be shown that the consideration requirement *as currently applied* does not produce fair results, then it can no longer be defended on the basis that it allows the courts to enforce contracts where there is good reason to do so. Whether this is the case will be assessed in chapter two.

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[74] English Law Revision Committee, above n 42, at [29] – [30].
[75] Property Law Act 2007, s 24.
[76] P S Atiyah "Consideration: A Restatement" in P S Atiyah *Essays on Contract* (Oxford University Press, New York, 1990) at 181.
[77] Smith, above n 1, at 231.
[78] See Val D Ricks "The Sophisticated Doctrine of Consideration" (2001) 9 GMLR 99 for an analysis of the doctrine of consideration's historical development from assumpsit. Ricks argues that consideration was simply one reason to enforce a promise; a sufficient but not always a necessary ground for an action on a promise (at 141-142).

PART III: CONCLUSION

In this chapter it has been argued that the law of contract aims to protect the reasonable expectations of promisees, insofar as they correspond with the objectively manifested intention of the promisor to be legally bound. If this is true, there must be a strong justification for any additional requirement for contract formation beyond intention to be bound. The consideration requirement does not have a strong justification. Neither the bargain theory nor the formal function of consideration provide an adequate basis for its continued application as an essential requirement for contract formation. The next step is to consider whether the consideration requirement produces unfair results in practice. If it does, given its lack of principled basis, it should be abolished as a necessary element of a valid contract.