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## The law of contract: Contractual 'ingredients'

### Background

I'll bet that by the time you are reading this, you'll have already made a large number of contracts this week. Every time you go into a shop or supermarket to buy something you are making a fully legally binding contract with the shop or supermarket to buy whatever the article purchased may be: crisps, a bar of chocolate or a bottle of water or wine.

Contracts of this type are called 'simple verbal' contracts. By their nature these contracts do not have to be made in writing. Some contracts of course do have to be made in writing and these are referred to by lawyers as 'speciality' contracts. The reason that these speciality contracts have to be made in writing is historical more than anything else and these types of contracts shouldn't bother you in your study of business law. You are unlikely to come up against too many of these, but please be just aware of them. You are very unlikely to be expected to analyse these on a first-year undergraduate business course.

However, there are good reasons why some contracts should be made in writing. If, for example, you are buying or selling a house, English law requires that you will need the contractual document to be in writing. This is also true when buying or selling shares in a public limited company. By and large I think it's safe to leave these types of contracts to the lawyers. For yourself, of course, it is quite handy to have a written document stating that you actually own the house you've just bought. As far as your study of business law goes, the chances are that you'll only be asked to analyse certain internal aspects of contracts and you can largely ignore whether they were written or verbal contracts.

To get an idea of just how many simple verbal contracts there are, think of a supermarket that you regularly use; now try to think how many people use this shop each day. Then multiply this number by 364 for the number of days in the year. We'll allow them Christmas day off. The number you come up with will certainly be in the hundreds of thousand or even millions. This is just taking one supermarket and ignores all the others. It also ignores all the other retail outlets throughout the land.

So, if anyone tells you that all contracts have to be made in writing, ignore them and tell them to clear off. Only a minority of contracts must be made in writing. To emphasise the point, the vast number of fully legally binding contracts being formed each day are simple verbal contracts. All of these are just as 'legal' and enforceable as any written contract would be. I've had students, even towards the end of some of my law courses, telling me that all contracts must be made in writing. This sort of thing worries me.

Just out of interest and to put matters in context, over 540 million tins of baked beans are sold in the UK every year. I'll bet that not a single tin changed hands using a written contract

Having fully legally binding verbal contracts is a very practical arrangement. It would be silly if each time you used a shop, you had to sign a written agreement before you could buy anything. The queues would be so long that it would take you hours to do your shopping. I bet you'd think twice before buying frozen beef burgers (or frozen Linda McCartney sausages for the vegies amongst us).

For verbal contracts, the term 'simple' is used not because these contracts are simple in themselves, but to distinguish them from the above mentioned 'speciality' contracts.

In business, naturally most transactions form written contracts, but as said above you will not be asked to analyse the written aspect of these contracts in any detail. It is much more likely that you will be asked to consider the underlying principles of contract law itself. These principles are pretty much common to all contracts whether written or verbal. It's these we'll look at shortly.

Before we do this, let's take a little aside and consider the value of contract law to businesses. Businesses can't trade with other businesses, and indeed customers, for very long without some underlying system of trust. Would you do business with another business that you know won't pay you? I doubt it very much. It's the framework of contract law which reinforces this trust.

All parties to business contracts have the underlying concept in their heads that if, for example, a company to which you've supplied with goods ends up refusing to pay you, well you'll simply sue them for the money. That doesn't mean that you won't meet people and businesses which are slow to pay you. You will – that's business.

To continue, contracts form an agreement between two or more parties which are intended to be legally binding – we will look at the legally binding part shortly. These can be agreements between one person and another person, one business and another business or between a business and a person – or any combination of the above.

- One person and another person* – You agree to buy a car belonging to a friend.
- Business to business* – Tesco buys milk from a farm to sell in its stores.
- Business and a person* – You buy a packet of mints from a shop.

For all of these contracts to be legally binding, English law requires that there must be certain basic elements present to ensure that the contract is enforceable. If one or more of these ingredients are not present then there is no contract. The most important of these contractual requirements are the following:

## Contractual 'ingredients'

- A. It must be established that there has been a proper (formal) offer and a proper (formal) acceptance.
- B. There has to be an intent to enter into a legally binding agreement (sometimes this is written as legal intent or an intent to create legal relations – they all mean the same thing).
- C. It has to be established that there must be 'consideration' flowing from each party to the other party, i.e. something of value (to each contracting party) flowing in each direction from one party to the other party. *Consideration*, please be clear, is not a difficult concept. It's simply the benefit you get from entering into any contract. It's also the benefit the other person gets from entering into a contract with you. If both parties aren't going to each benefit in some way by contracting, then they wouldn't contract in the first place!
- D. The contracting parties must have the capacity to contract (this normally is concerned with the ability of children to make contacts or people who've had one Carlsberg too many and can't remember what they may have agreed to).