

## **The Price of a Contract – Consideration**

(Relevant to PBE Paper IV – Business Law and Taxation)

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### **Introduction**

Contract law is the most essential subject in business law. All kinds of business transactions are contractual, and therefore having a thorough understanding of contract law is a pre-requisite for students in exploring other, more advanced legal topics. One of the most difficult contract law topics is consideration. In this article, we discuss the meaning of consideration and its likely appearance in some typical examination questions. This topic is also relevant to chapters 3, 4 and 5 of the official textbook of PBE Paper IV.

### **The Price of a Contract**

There is no such thing as a free lunch. This holds true in the business world, as well as in our common law system. The cradle of contract law was the presence of a market economy, and the market economy was based on exchange, trade and transactions. People would trade for those things that they wanted, and their agreements arising from such were protected by laws. From this framework a very important concept arises: our common law will not enforce a gift or a bare promise. The rationale underlying this is that contract law is based on exchange, and the nature of an exchange is commercial. A commercial contract must be supported by a price or something with economic value. Therefore, granting of a gift, bare promise or any intangible things are not enough to justify a contract, and such agreements shall not be protected by our contract law.

### **Consideration**

Consideration is a promise of something of value to be given by one party in exchange for something of value given by another party. That said, consideration means value. It is the price paid by the contracting parties in securing the enforceability of a contract. It reflects the existence of a bargain behind the promise and agreement. Consideration need not be monetary in nature, but must be something of value. It may be either (i) some interest or benefit given to the other party; or (ii) some detriment, loss or responsibility accepted by one's own party. For example, suppose John wanted to buy a handbag from Mary. He may offer to pay her \$1,000 or to help her to wash her car. The \$1,000 is an interest or benefit, while washing the car is a detriment, loss or responsibility undertaken of his own volition. They are both valid forms of consideration.

## **The Four Principles**

There are four guiding principles in consideration. These four principles illustrate the essential features of consideration.

- 1) Consideration must be corresponding.
- 2) Consideration must move from the promisee.
- 3) Consideration must have value.
- 4) Consideration must be sufficient but need not be adequate.

### Principle 1 – Corresponding

The guiding principle here is that consideration given must be corresponding with the promise from the other party. For example, suppose that Mr. A voluntarily helped Mr. B to wash his car, then Mr. B promised to pay him \$100 after the work was finished. In this instance, there is no contract between them because there is no corresponding consideration. For Mr. A, the washing of the car was not performed in exchange for the promise to pay \$100. For Mr. B, the promise to pay \$100 was not in exchange for the help given by Mr. A (the work had already finished at the time of the promise).

There are two typical types of exam questions concerning corresponding:

The first type is about past consideration. Students will normally be given a situation, in which the contract had been made already, but then a further promise was offered by either party. In contract law, this is called past consideration. Students need to clearly point out that if a contract had already been established, then that contract shall be treated as fully settled. Everything in addition or afterward must be supported by a new consideration.

The second type of exam question concerns the performance of an existing duty. Usually, a scenario will be given about a person who wanted to use his existing duty as a consideration to support a contract. Students are being tested on their ability to tell the difference between an existing duty and an additional or new workload that is specifically for the contract. An existing duty is also a kind of past consideration, and students must clearly point out that consideration must be corresponding with the existing contract.

### Principle 2 – From the Promisee

In general, a promisee (the one receiving a promise) can maintain an action on a promise made to him, but when the consideration moves not from the promisee, but some other person, the latter, and not the promisee, has a cause of action. This is because he is the person for whose sake the contract was made. This simply means that only a person who gave consideration can enforce the contract. In some typical scenarios, two parties have made a contract but for some reason(s), one of them is not enforcing it. An outside party has then tried to step in and to enforce the rights of the contract. Students should be capable of identifying the right party by referring to

his identity, who is the one involved in giving the consideration and who shall be capable of enforcing the right in the contract.

### Principle 3 – Value

Consideration must be of value. It is not necessary for value to be money or anything that can be measured in monetary terms. A detriment incurred by oneself or a benefit given to the other party can both be valid forms of consideration. That said, consideration can be a service or voluntarily giving up certain rights. There is no objective standard as to the existence of value, but rather, it is the result of the negotiation and mutual agreement of the parties. Normally, questions concerning value will tend to be relatively straightforward. Students are asked to identify what is of value in a given scenario. The questions usually list out things that seem to have no relationship with consideration, and students need to explain those things by referring to the concept and definition of consideration.

### Principle 4 – Sufficient but Not Adequate

Consideration must have value but need not have the same or equal value. The court is concerned with whether something with value existed but is not interested in knowing whether the things exchanged are proportional in value or not. Sufficient means something with value existed. Adequate means that the values exchanged are the same or equal. Note, however, that intangible things like love, respect and care are not valuable consideration because they do not have tangible value.

Usually, students are tested on a given case concerning the price paid by the parties. It may be that one party accepted an exceptionally low price, which seems to be unreasonable. It may also be that some kind of thing is given that is not recognisable by the law at all. Students have to analyse each of these cases by referring to the abovementioned principles.