
UNIT 1 ESSENTIALS OF A CONTRACT

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1.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the purpose of law;
- describe the sources of business law;
- explain the meaning of contract;
- distinguish between a contract and an agreement;
- classify the contracts;
- distinguish between void, voidable and illegal contracts; and
- describe the essentials of a valid contract.

1.1 INTRODUCTION

The law of contract is the most important branch of Business Law. Without such a law it would be difficult, if not impossible, to carry on any trade or business in a smooth manner. The law of contract is applicable not only to business but also to all day-to-day personal dealings. In fact, each one of us enter into a number of contracts from sunrise to sunset. When a person buys

a newspaper or rides a bus or purchases goods or gives his radio for repairs or borrows a book from library, he is actually entering into a contract. All these transactions are subject to the provisions of the law of contract. So one should know the law relating to contracts, not only for business but for all personal dealings. In this introductory unit you will learn, first of all, why we need law and what its various branches are. Then you will learn about the meaning of business law, its sources, and the basic aspects of the law of contract viz., the meaning of contract, its classification and the essentials of a valid contract.

1.2 WHAT IS LAW?

Before learning the meaning of the term ‘Law’ you must know as to why we need law. No civilised society can exist without law. It is required for the preservation of peace and orderliness in every society. Without law, no person will care for others and their dealings may not materialise. With the growth of society and the concept of welfare state, it became necessary to regulate the conduct of people and protect their property and contractual rights. Hence, each country enacted laws suited to its various needs and the value system it cherished.

It is imperative that we should know the law to which we are subject, because ignorance of law is no excuse. For example, if a person is caught travelling in a train without ticket, he cannot plead that he was not aware of the rule regarding the purchase of ticket and therefore he may be excused. Hence, in our own interest, we should be conversant with the laws that are applicable to us.

Law means a ‘set of rules’. Broadly speaking, it may be defined as the rules of conduct recognised and enforced by the state to control and regulate people’s behaviour with a view to securing justice, peaceful living and social security. Some of the important definitions of the term ‘law’ are as follows:

“Law is a rule of civil conduct, prescribed by the supreme power of state, commanding what is right and prohibiting what is wrong.” Blackstone.

“Law is the body of principles recognised and applied by the state in the administration of justice.” – Salmond.

From the definitions given above, you will notice that law is a set of rules and principles relating to human actions with a view to regulate the actions of human beings in respect of one another and in relation to the society. You know the society is not static, its value system keeps on changing. Hence, law also keeps changing according to the changing requirements of the society.

There are several branches of law, such as international law, constitutional law, criminal law, civil law, etc. Every law regulates and controls a particular field of activity. Business law also known as mercantile law or commercial law is not a separate branch of law. **It is a part of civil law which deals with the rights and obligations of mercantile persons arising out of commercial transactions in respect of mercantile property.**

1.3 MEANING AND SOURCES OF BUSINESS LAW

You have learnt that business law is a part of civil law and it governs and regulates the trade and commerce in a country. In other words, the business law

groups together laws that are considered important for men in business and includes laws relating to various contracts, partnerships, companies, negotiable instruments, insurance, carriage of goods, arbitration, etc.

Indian business law is primarily an adaptation of the English law. The different Indian Acts follow, to a considerable extent, the English mercantile law with some reservations and modifications necessitated by the peculiar conditions prevailing in India. The main sources of business law in India are as follows:

- 1) English Mercantile Law:** Our laws are based primarily on the English laws which developed through customs and usages of merchants or traders in England, these customs and usages governed these merchants in their dealings with each other. This law is also known as ‘Common Law’. As a matter of fact, it is an unwritten law based on customs, usages and precedents. The most important part of mercantile law, namely, the Law of Contracts, is still a part of Common Law in England.
- 2) Indian Statute Law:** The Acts passed by the Indian Legislature are the main source of Indian business law. The important Acts passed by the Indian Legislature are: The Indian Contract Act 1872; The Negotiable Instruments Act 1881; The Sale of Goods Act 1930; The Indian Partnership Act 1932; The Companies Act 2013; Consumer Protection Act 1986; The Securities and Exchange Board of India Act, 1992; The Information Technology Act, 2000, and so on.
- 3) Judicial Decisions (or case law):** The past judicial decisions of courts are another important source of law. They are generally followed by the courts while deciding similar cases before them. The past decisions have persuasive and guiding value. Wherever the law is silent on a point, the judge has to decide the case according to the principle of equity, justice and good conscience. The decisions of English courts are also frequently referred to as precedents in deciding various cases and for interpreting the Indian Statutes.
- 4) Customs and Usages:** The customs and usages of particular trade are yet another important source of Indian mercantile law. They play an important role in regulating the dealings between the merchants of that trade. But it is necessary that such customs or usages must be widely known, reasonable, constant and must not be inconsistent with the law. The Indian Contract Act recognises this fact by providing that “nothing contained therein shall affect any usage or custom of trade.” The Negotiable Instruments Act also makes a similar provision. It says that “nothing contained therein shall affect any local usage relating to instruments in an oriental language.”

1.4 THE LAW OF CONTRACT

The law of contract is the most important part of business law in India. It determines the circumstances in which the promises made by the parties to a contract shall be binding on them and provides for the remedies available against a person who fails to perform his promise. The law of contract is contained in the Indian Contract Act, 1872, which deals with the general principles of law governing all contracts and covers the special provisions relating to contracts like bailment, pledge, indemnity, guarantee and agency.

Before 1930, this Act also contained the special provisions relating to contracts of sale of goods and partnership. In 1930, however, these provisions were repealed and separate Acts called the ‘Sale of Goods Act’ and the ‘Indian Partnership Act’ were passed governing the contracts of sale of goods and partnership respectively. Similarly, there are separate Acts for contracts relating to negotiable instruments, insurance, carriage of goods, etc.

Let us now study the exact nature of a contract and the other important aspects relating to it.

1.5 WHAT IS A CONTRACT

Broadly speaking, a contract is an agreement made between two or more persons to do or to abstain from doing a particular act. A contract invariably creates a legal obligation between the parties by which certain rights are given to one party and a corresponding duty is imposed on the other party. A contract has been defined by different authorities in various ways. Some of the important definitions are as follows:

A contract is an agreement, creating and defining the obligation between parties. – Salmond

A contract is an agreement enforceable at law made between two or more persons by which rights are acquired by one or more to acts or forbearance on the part of others. – Sir William Anson

Every agreement and promise enforceable at law is a contract.

– Sir Fredrick Pollock

The definition as given in the Contract Act is based on Pollock’s definition. Section 2(h) of the Act states that an agreement enforceable by law is a contract. On analysing this definition of contract, you will notice that a contract essentially consists of two elements: (i) an agreement, and (ii) its enforceability by law.

Let us discuss these two elements in detail.

1.5.1 Agreement

Section 2(e) of the Contract Act defines agreement as *every promise and every set of promises forming the consideration for each other*. In this context a promise refers to a proposal (offer) which has been accepted. For example, Ramesh offers to sell his scooter for Rs. 20,000 to Shyam. Shyam accepts this offer. It becomes a promise and treated as an agreement between Ramesh and Shyam. In other words, an agreement consists of an offer by one party and its acceptance by the other. Thus,

Agreement = Offer + Acceptance

From the above analysis it is clear that there must be at least two parties to an agreement, one making an offer and the other accepting it. No person can enter into agreement with himself. There is another important aspect relating to an agreement i.e., the parties to an agreement must have an identity of minds

in respect of the subject matter. They must agree on the same thing in the same sense. This is also called *consensus-ad-idem*. Suppose A has two houses, one situated in South Delhi and the other in North Delhi. He offers to sell his North Delhi house to B while B is under the impression that he is buying the South Delhi house. Here, there is no identity of minds. Both the parties are thinking about different houses. Hence there is no agreement.

1.5.2 Legal Obligation

In order that an agreement may be regarded as a contract, it must give rise to a legal obligation i.e., it must be enforceable by law. Any obligation (duty) which is not enforceable by law is not regarded as a contract. Social, moral or religious agreements do not create any legal obligation. For example, an agreement to take lunch together or to go to a picnic is not a contract because it does not create a duty enforceable by law. Such agreements are purely of a social nature where there is no intention to create legal relationship. Hence, they do not result in contracts. In case of business agreements, however, the usual presumption is that the parties intend to create a legal relationship. For example, an agreement to sell a scooter for Rs. 20,000 is a contract because it gives rise to an obligation enforceable by law. In this agreement if there is default by either party, an action for breach of contract can be enforced through a court of law provided all the essentials of a valid contract are present in the agreement.

You must also note that every obligation which is enforceable by law is not automatically regarded as a contract. The obligations which do not arise out of agreements but from sources such as wrongful acts, judicial decisions or decree of a court, husband and wife relationship are not regarded as contracts. Thus, the **law of contract is concerned with only those obligations which arise out of agreement**. Salmond has rightly said about the law of contract that “.....It is the law of those agreements which create obligations, and those obligations which have their source in agreements.”

1.5.3 Difference between an Agreement and a Contract

Agreement	Contract
1) Offer and its acceptance constitute an agreement.	1) Agreement and its enforceability constitute a contract.
2) An agreement may not create a legal obligation.	2) A contract necessarily creates a legal obligation.
3) Every agreement may not be a contract.	3) All contracts are agreements.
4) Agreement is not a concluded or a binding contract.	4) Contract is concluded and binding on the concerned parties.

Check Your Progress A

- 1) What is Law?
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-
-

2) Define contact.

.....

3) Define an agreement.

.....

4) What do you mean by legal obligation?

.....

5) State whether the following statements are True or False.

- i) Law is the body of principles enforced by judiciary.
- ii) Business law is applicable to business community only.
- iii) Customs and usages are an important source of business law.
- iv) Law of contracts is the law of all obligations.
- v) All contracts are agreements.
- vi) There can be a contract without *consensus ad idem*.

1.6 CLASSIFICATION OF CONTRACTS

Contracts can be classified on a number of bases. They are:

- 1) On the basis of creation
- 2) On the basis of execution
- 3) On the basis of enforceability

1.6.1 On the Basis of Creation

A contract may be (i) made in writing or by word of mouth or (ii) inferred from the conduct of the parties or circumstances of the case. The first category of contract is termed as ‘express contract’ and the second as ‘implied contract’

- i) **Express Contract:** An express contract is one where the terms are clearly stated in words, spoken or written. For example, A wrote a letter to B stating “I offer to sell my car for Rs. 30,000 to you”, B accepts the offer by letter sent to A. This is an express contract. Similarly, when A asks a scooter mechanic to repair his scooter and the mechanic agrees, it is an express contract made orally by spoken words.
- ii) **Implied Contract:** A contract may be created by the conduct or acts of parties (and not by their words spoken or written). It may result from a

continuing course of conduct of the parties. For example, where a coolie in uniform carries the luggage of A to be carried out of railway station without being asked by A to do so and A allows it, the law implies that A has agreed to pay for the services of the coolie. This is a case of an implied contract between A and the coolie. Similarly, when you board a bus or metro rail, an implied contract comes into being. You are bound to pay the prescribed fare.

There is another category of implied contracts recognised by the Contract Act known as quasi-contracts (Sections 68 to 72). Strictly speaking, a quasi-contract cannot be called a contract. It is regarded as a relationship resembling that of a contract. In such a contract the rights and obligations arise not by an agreement between the parties but by operation of law. For example, A, a trader, left certain goods at Bs house by mistake. B treated the goods as his own and consumed it. In such a situation, B is bound to pay for the goods even though he has not asked for the goods. You will learn about the quasi-contracts in detail in Unit 8.

1.6.2 On the Basis of Execution

On the basis of the extent to which the contracts have been performed, we may classify them as (i) executed contracts, and (ii) executory contracts.

- i) **Executed Contracts:** It is a contract where both the parties have fulfilled their respective obligations under the contract. For example, A agrees to sell his book to B for Rs. 50. A delivers the book to B and B pays Rs. 50 to A. It is an executed contract.
- ii) **Executory Contracts:** It is a contract where both the parties to the contract have still to perform their respective obligations. For example, A agrees to sell a book to B for Rs. 50. If the book has not been delivered by A and B has not paid the price, the contract is executory.

A contract may sometimes be partly executed and partly executory. It happens where only one of the parties has performed his obligation. In the example given above, if A has delivered the book to B but B has not paid the price. the contract is executed as to A and executory as to B.

On the basis of execution, a contract can also be classified as unilateral or bilateral. A unilateral contract is one in which only one party has to perform his obligation, the other party had fulfilled his part of the obligation at the time of the contract itself. For example, A buys a ticket from the conductor and is waiting in the queue for the bus. A contract is created as soon as the ticket is purchased. The other party is now to provide a bus wherein he could travel. A bilateral contract is one in which the obligations on the part of both the parties are outstanding at the time of the formation of the contract.

1.6.3 On the Basis of Enforceability

From the point of view of enforceability a contract may be (i) valid, (ii) void, (iii) voidable, (iv) illegal or (v) unenforceable. These terms shall be used quite frequently in this course. Hence, you must form a clear idea about their respective meanings.

- i) **Valid Contract:** A contract which satisfies all the conditions prescribed by law is a valid contract. (These conditions are discussed in Section 1.7.) If

one or more of these elements is/are missing, the contract is either void, voidable, illegal or unenforceable.

- ii) **Void Contract:** According to Section 2 (j) *A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.* It is a contract without any legal effects and is a nullity. You should note that a contract is not void from its inception. It is valid and binding upon the parties when made, but subsequent to its formation, due to certain reasons, it becomes unenforceable and so treated as void. A contract may become void due to impossibility of performance, change of law or some other reasons. For example, A promised to marry B. Later on, B dies. This contract becomes void on the death of B. **A void contract should be distinguished from void agreement.** Section 2(g) says that *an agreement not enforceable by law is said to be void.* In the case of void agreement no contract comes into existence. Such an agreement confers no rights on any person and creates no obligations. It is void ab-initio i.e., from the very beginning. For example an agreement with a minor is void because a minor is incompetent to contract.

Now it should be clear to you that a void agreement is not the same thing as a void contract. A void agreement never matures into a contract, it is void from the very beginning. A void contract, on the other hand, was valid when it was entered into, but subsequently, because of one reason or the other, became void. **A contract cannot be void ab-initio, it is only an agreement which can be void ab-initio.**

- iii) **Voidable Contract:** According to Section 2(i) of the Contract Act, An agreement which is enforceable by law at the option of one or more of the parties thereon, but not at the option of the other or others, is a voidable contract. Thus, a voidable contract is one which can be set aside or repudiated at the option of the aggrieved party. Until it is set aside or avoided by the party entitled to do so, it remains a valid contract. A contract is usually treated as voidable when the consent of a party has not been free i.e., it has been obtained either by coercion, undue influence, misrepresentation or fraud. The contract is voidable at the option of the party whose consent has been so caused. For example, A threatens to shoot B if he does not sell his new scooter to A for Rs. 5,000. B agrees. Here the consent of B has been obtained by coercion. Hence, the contract is voidable at the option of B, the aggrieved party. If, however, B does not exercise his option to set aside the contract within a reasonable time and if in the meanwhile a third party acquires a right in relation to the subject matter for some consideration, the contract cannot be avoided. For example, A obtains a ring by fraud. Here, B's consent is not free and therefore he can cancel this contract. But if, before this option is exercised by B, A sells the ring to C who acquires it after paying the price and in good faith, contract cannot be avoided. You should note that the option to set aside the contract on this ground is not available to the other party. Hence, **if the aggrieved party chooses to regain the contract, it remains enforceable by law.** If however, the aggrieved party avoids the contract, the other party is also freed from his obligation to perform the contract and if the party avoiding the contract has received any benefit under the contract, he must restore such benefit to the person from whom it was received (Section 64).

Void Agreement	Voidable Contract
1) It is void from the very beginning.	1) It remains valid till it is repudiated by the aggrieved party.
2) A contract is void if any essential element of a valid contract (other than free consent) is missing.	2) A contract is voidable if the consent of a party is not free.
3) It cannot be enforced by any party.	3) If the aggrieved party so decides, the contract may continue to be valid and enforceable.
4) Third party does not acquire any rights.	4) An innocent party in good faith and for consideration acquires good title before the contract is avoided.
5) Lapse of time will not make it a valid contract, it always remains void.	5) If it is not avoided within reasonable time, it may become valid.
6) Question of damages does not arise	6) The aggrieved party can also claim damages.

- iv) **Illegal or unlawful contract:** The word ‘illegal’ means contrary to law. You know that contract is an agreement enforceable by law and therefore, it cannot be illegal. It is only the agreement which can be termed as illegal or unlawful. Hence, **it is more appropriate to use the term ‘illegal agreement’ in place of ‘illegal contract’.**

An ‘illegal agreement’ is one which has been specifically declared to be unlawful under the provisions of the Contract Act or which goes against the provisions of any other law of the land. Such agreement cannot be enforced by law. For example, A agrees to pay Rs. 50,000 to B if B kills C. This is an illegal agreement because its object is unlawful. Even if B kills C, he cannot claim the agreed amount from A.

The term ‘illegal agreement’ is wider than the term ‘void agreement’. **All illegal agreements are void but all void agreements are not necessarily illegal.** For example, an agreement to sell a scooter to the minor i.e. void but it is not illegal because the object of this agreement is not unlawful. The other important difference between the illegal and the void agreement relates to their effect on the transactions which are collateral to the main agreement. **In case of illegal agreements even the collateral agreements become void.** For example, A engages B to shoot C. To pay B, A borrows Rs. 10,000 from D who is aware of the purpose of the loan. In this case, there are two agreements – one between A and B and the other between A and D. Since the main agreement between A and B is illegal, the agreement between A and D which is collateral to the main agreement is also void. D cannot recover the money from A. Take another example. A borrows money from D to pay off his wagering (betting) debts to B. Here the main agreement is void (not illegal). Hence the agreement between A and D being a collateral agreement shall not be affected even

though D was aware of the purpose of the loan. From these examples, it should be clear to you that the agreements collateral to the illegal agreements are also void but the transactions collateral to void agreements are not affected in any way, they remain valid.

Difference between Void Agreement and Illegal Agreement

Void Agreement	Illegal Agreement
1) All void agreements are not necessarily illegal.	1) All illegal agreements are void.
2) Collateral transactions to a void agreement are not affected i.e., they do not become void.	2) Collateral transactions to an illegal agreements are also affected i.e., they also become void.
3) If a contract becomes void subsequently, the benefit received has to be restored to the other party.	3) The money advanced or thing given cannot be claimed back.
v) Unenforceable contract: It is a contract which is actually valid but cannot be enforced because of some technical defect. This may be due to non-registration of the agreement, non-payment of the requisite stamp fee, etc. Sometimes, the law requires a particular agreement to be in writing. If such agreement has not been put in writing, it becomes unenforceable. For example, an oral agreement for arbitration are unenforceable because the law requires that an arbitration agreement must be in writing. It is important to note that in most cases, such contracts can be enforced if the technical defect involved is removed. For example, if the document which embodies a contract is understamped, it will become enforceable if the requisite stamp is affixed.	

Look at Figure 1.1. It gives a bird's eyeview of the different type of contracts.

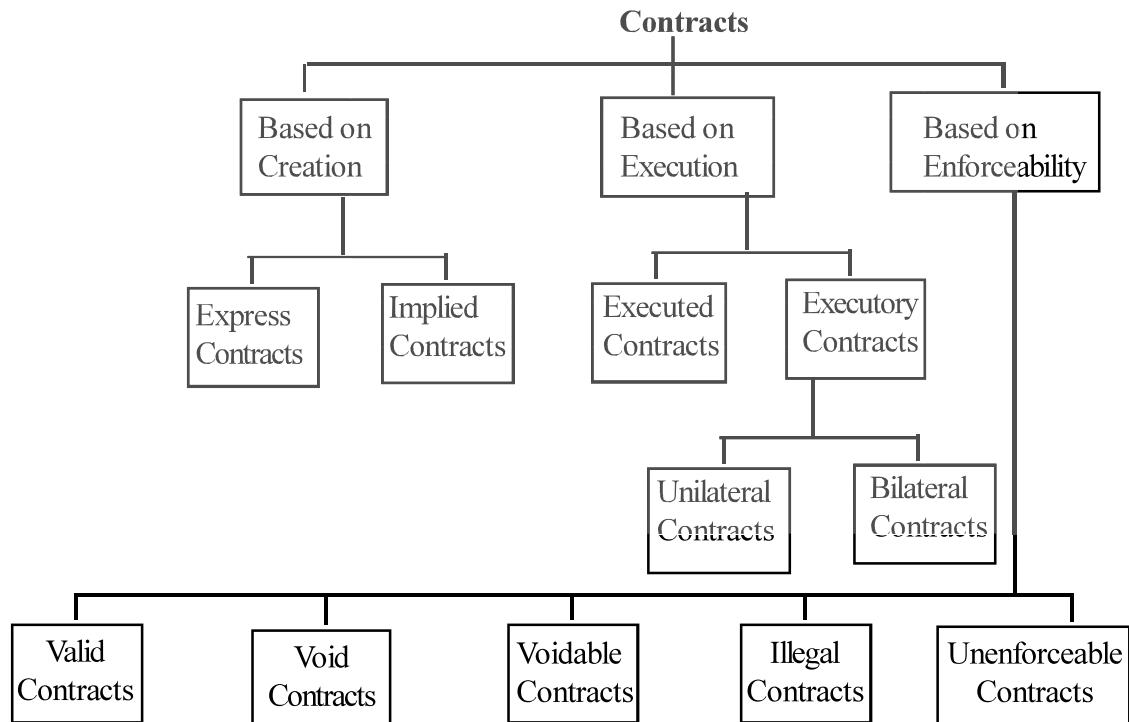


Fig. 1.1: Classification of Contracts

- 1) What is a void contract?

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- 2) When is a contract voidable?

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- 3) What is an illegal agreement?

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- 4) State whether a contract is created in the following cases. Write 'Yes' or 'No'

- i) A boards a public vehicle for Agra.
ii) A engages B to smuggle goods into India.
iii) A invites B for dinner at his house.
iv) A engages B to do cooking for Rs. 500.

- 5) Give your decision in case of the following problems in a word or two.

- i) A invites B to dinner. B accepts the invitation but fails to turn up. Can A sue B for the damages?
ii) A agrees to marry B. B dies before the marriage takes place. What happens to the contract?
iii) A promises to give a ring at the time of the marriage of his friend B. He fails to give the ring. Can B claim the ring?
iv) A sold a scooter to B saying that it was a brand new scooter. In fact the scooter was not new. Can B avoid the contract?
v) A promises to pay B Rs. 2,000 if B beats C. B beats C. Can B recover the amount from A?

1.7 ESSENTIALS OF A VALID CONTRACT

You have learnt that an agreement enforceable by law is a contract. An agreement in order to be enforceable must have certain essential elements.

According to Section 10, *All agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.* Thus, an agreement becomes a valid contract if it has the following elements.

- 1) Proper offer and its proper acceptance
- 2) Intention to create legal relationship
- 3) Free consent
- 4) Capacity of parties to contract
- 5) Lawful consideration
- 6) Lawful object
- 7) Agreement not expressly declared void
- 8) Certainty of meaning
- 9) Possibility of performance
- 10) Legal formalities

Let us now discuss these essential elements one by one.

- 1) **Proper offer and proper acceptance:** In order to create a valid contract it is necessary that there must be at least two parties, one making the offer and the other accepting it. The law has prescribed certain rules for making the offer and its acceptance that must be satisfied while entering into an agreement. For example, the offer must be definite and duly communicated to the other party. Similarly, the acceptance must be unconditional and communicated to the offerer in the prescribe mode, and so on. Unless such conditions with regard to the offer and the acceptance are satisfied the agreement does not become enforceable. You will learn about offer acceptance in detail in Unit 2.
- 2) **Intention to create legal relationship:** There must be an intention among the parties to create a legal relationship. If an agreement is not capable of creating a legal obligation it is not a contract. In case of social or domestic agreements, generally there is no intention to create legal relationship. For example, in an invitation to dinner there is no intention to create legal relationship and therefore, is not a contract. Similarly, certain agreements between husband and wife do not become contracts because there is no intention to create legal relationship. This point can well be illustrated by the famous case of **Balfour v. Balfour**. Mr. Balfour had promised to pay £30 per month to his wife living in England when she could not accompany him to Caulon where he was employed. Mr. Balfour failed to pay the promised amount. Mrs. Balfour filed a suit against her husband for breach of this agreement, It was held that she could not recover the amount as it was a social agreement and the parties never intended to create any legal relations.

In commercial or business transactions the usual presumption is that the parties intend to create legal relations. However, this presumption may be negated by express terms to the contrary. The case of **Rose & Frank**

Co. v. Crompton Brothers is relevant here. In this case there was an agreement between Rose & Frank Company and Crompton Brothers Ltd. whereby the former was appointed as selling agents in North America. One of the clauses in the agreement read, “This agreement is not entered into as a formal or legal, agreement and shall not be subject to legal jurisdiction in the law courts.” It was held, that this agreement was not a legally binding contract as there was no intention to create legal relations.

You must note that whether intention to create legal relationship exists in an agreement or not is a matter for the court to decide which may look at the terms and conditions of the agreement and the circumstances under which the agreement was made

- 3) **Free consent:** For a contract to be valid, it is essential that there must be free and genuine consent of the parties to the contract. They must have made the contract of their own free will and not under any fear or pressure. According to Section 14, *consent is said to be free when it is not caused by (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation, or (v) mistake*. In case the consent is obtained by any of the first four factors, the contract would be voidable at the option of the aggrieved party. But if the agreement is induced by mutual mistake which is material to the agreement, it would be void. You will learn about free consent in detail in Unit 4.
- 4) **Capacity of parties:** The parties to an agreement must be competent to contract i.e., they must be capable of entering into a contract. If any party to the contract is not competent to contract, the contract is not valid. Now the question arises as to who are competent to contract? Answer to this question is provided by Section 11 of the Act which says that *every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind, and is not disqualified from contracting by any law to which he is subject*.

From this section you will notice that in order to be competent to enter into a contract, the person should be a major (adult), should be of sound mind and he must not be declared disqualified from contracting by any law to which he is subject. Thus, the flaw in capacity may be due to minority, lunacy, idiocy, etc. If a party to a contract suffers from any of these flaws, the agreement, with a few exceptions, is not enforceable by law. This point has been discussed at length in Unit 3.

- 5) **Lawful consideration:** An agreement must be supported by consideration. Consideration means something in return. It is also defined as the price paid by one party to buy the promise of the other. However, this price need not always be in terms of money. For example, A agrees to sell his book to B for Rs. 50. Here the consideration for A is Rs. 50, and for B it is the book.

The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. The consideration may be past, present or future, consideration must be real i.e., it must have some value in the eyes of law. However, the consideration need not be adequate. For example, A sells his car worth Rs. 2,00,000 to B for Rs. 50,000 only. This is a valid promise provided the consent of A is free.

For a contract to be valid, the consideration should also be lawful. The consideration is considered lawful unless it is forbidden by law, or is fraudulent, or involves or implies injury to the person or property of another, or is immoral, or is opposed to public policy (Section 23). The law regarding consideration is discussed in detail in Unit 5.

- 6) **Lawful object:** The object of an agreement must be lawful. An agreement made for any act which is prohibited by law will not be valid. For example, if A rents out a house for use as a gambling den, the agreement is void because the object of the agreement is unlawful. If the object is unlawful for any of the reasons mentioned in Section 23, the agreement shall be void. Thus, the consideration as well as the object, of the agreement should be lawful.
- 7) **Agreement not expressly declared void:** The agreement must not have been expressly declared void under Contract Act. Sections 24 to 30 specify certain types of agreements which have been expressly declared void. They are agreement in restraint of marriage, agreement in restraint of legal proceedings, agreement in restraint of trade and agreement by way of wager.

For example, A agreed to pay Rs. 10,000 to B if he (B) does not marry throughout this life. B promised not to marry at all. This agreement shall not be valid because it is in restraint of marriage which has been expressly declared void under Section 26.

You should note that if an agreement possesses all other essential elements of a valid contract but belongs to the category of such agreements that have been expressly declared void by the Contract Act, no power on earth can make it a valid contract.

- 8) **Certainty of meaning:** Section 29 of the Contract Act provides that *Agreements, the meaning of which is not certain or capable of being made certain, are void.* Thus to make a valid contract it is absolutely essential that its terms must be clear and not vague or uncertain. For example, A agreed to sell 100 tonnes of oil to B. Here it is not clear what kind of oil is intended to be sold. Therefore, this agreement is not valid on the ground of uncertainty. If, however, the meaning of the agreement could be made certain from the circumstances of the case, it will be treated as a valid contract. In the example given above if we know that A and B are dealers in mustard oil only, then the agreement shall be enforceable because the meaning of the agreement could be easily ascertained from the circumstances of the case.
- 9) **Possibility of performance:** The terms of the agreement must also be such as are capable of performance. An agreement to do an act impossible in itself is void (Section 56). If the act is impossible of performance, physically or legally, the agreement cannot be enforced by law. The reason is very simple. We make an agreement with a view to perform it and if the performance is not possible, what is the idea of making such agreements? For example, A promises to B that he will enclose some area between two parallel lines or that he will run at a speed of 200 km per hour or that he will bring gold from the moon. All these acts are such which are impossible of performance and therefore the agreement is not treated as valid.

- 10) **Legal formalities:** You have learnt that an oral agreement is as good as is a written agreement. The Contract Act does not require that a contract must be in writing to be valid. But, in some cases the Act has specified that the agreement must be made in writing, some agreements must be registered as well. For example, a promise to pay a time barred debt must be in writing and an agreement for a sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882. In such a situation, the agreement must comply with the necessary formalities as to writing, registration, etc. If these legal formalities are not carried out, then the contract is not enforceable by law.

After discussing the essential elements of a valid contract, it should now be clear to you that all these elements must be present in an agreement so that it becomes a valid contract. If any one of them is missing or absent, the agreement will not be enforceable by law.

1.8 LET US SUM UP

Law is the body of rules with regard to human conduct and actions which can be enforced in a court of law. There are several branches of law such as international law, constitutional law, criminal law, civil law, etc. Business law is an important branch of civil law which deals with laws relating to business transactions. The main sources of business law in India are the English laws, Indian statute laws, past judicial decisions, local customs and usages. The law of contracts is the most important part of business law which deals with general rules relating to all types of contracts and covers the special provisions relating to some specific contracts.

A contract is defined as an agreement enforceable by law. Hence, it consists of two main elements: (i) an agreement and (ii) its enforceability by law.

Contracts can be classified according to their (i) creation, (ii) execution, and (iii) enforceability. From the point of view of creation a contract may be either express or implied. From the point of view of execution it may be executed/executory or it may be unilateral/ bilateral, and from the point of view of enforceability it may be a valid, void, voidable, illegal or unenforceable contract.

An agreement not enforceable by law is said to be a ‘void agreement’. The term ‘void contract’ refers to an agreement which was valid when it was entered into but became void later on because of one reason or the other. A ‘voidable contract’ is one which is voidable (can be avoided) at the option of one party (aggrieved party) and not the other. An ‘illegal agreement’ is one where the object or the consideration is unlawful. Such agreement is also void and therefore not enforceable by law. An ‘unenforceable agreement’ is one which is valid but cannot be enforced because of some technical defect.

For an agreement to become a contract enforceable by law, it must have certain essential elements. These are: (i) there must be proper offer and its proper acceptance, (ii) there must be an intention to create legal relationship, (iii) the consent of the parties must be free, (iv) the parties must be competent to contract, (v) it must be supported by lawful consideration, (vi) the object of the agreement must be lawful, (vii) the agreement must not have been expressly declared void, (viii) the terms of the agreement must be certain and unambiguous,

(ix) the act involved should be such as is capable of performance, and (x) if there are certain formalities like registration, etc., they should be duly complied with.

1.9 KEY WORDS

Agreement: Every promise and set of promises, forming consideration for each other.

Bilateral Contract: A contract by which both the parties have yet to perform their respective promises.

Consensus ad-idem: Parties agreeing upon the same thing in the same sense.

Contract: An agreement enforceable by law.

Express Contract: An agreement made in writing or by word of mouth.

Illegal Agreement: An agreement the object of which is unlawful.

Implied Contract: An agreement inferred from the conduct of the parties.

Obligation: An undertaking to do or to abstain from doing some definite act.

Promise: An accepted proposal.

Unenforceable Agreement: An agreement which, though valid, cannot be enforced due to some technical defect.

Unilateral Contracts: A contract in which only one party has still to fulfil his obligation, while the other party has already fulfilled his own at the time of the formation of the contract itself.

Valid Contract: An agreement enforceable by law is a valid contract.

Void Agreement: An agreement not enforceable by law.

Void ab-initio: Something which is void from the very beginning.

Void Contract: An agreement which was valid when entered into but which subsequently becomes void.

Voidable Contract: A contract which can be avoided at the option of the aggrieved party.

1.10 ANSWERS TO CHECK YOUR PROGRESS

A) 5) i) True ii) False iii) True iv) False v) True vi) False

B) 4) i) Yes ii) No iii) No iv) Yes

5) i) No ii) contract becomes void iii) No iv) Yes v) No

1.11 TERMINAL QUESTIONS/EXERISES

1) What is a contract? Explain the essentials of a valid contract.

2) Comment on the following statements.

a) "All contracts are agreements but all agreements are not contracts."

- b) "The law of contract is not the whole law of agreements nor is it the whole law of obligations."
 - c) "In commercial and business agreements, the presumption is that the parties intend to create legal relations."
- 3) Distinguish between
- i) Void and Voidable contracts
 - ii) Void and Illegal agreements
- 4) Answer the following questions giving suitable reasons:
- i) A invites B to stay with him during winter vacation. B accepts the invitation and informs A accordingly. When B reaches A's house, he finds it locked and he has to stay in a hotel. Can B claim damages from A?
(Hint: B cannot claim any damages from A. It is a social agreement and there is no intention to create legal obligation.)
 - ii) A polished B's shoes without being asked by B to do so, B does not make any attempt to stop A from polishing the shoes. Is B bound to make payment to A?
(Hint: B is bound to pay A because he has accepted the offer by conduct.)
 - iii) A makes a promise to his son to give him pocket money of Rupees five hundred every month. After three months A stops making the payment. Advise the son.
(Hint: Son cannot compel his father as there was no intention to create legal relationship.)
 - iv) A promises to obtain for B an employment in a government office and B promises to pay Rs. 5,000 to A. Is the agreement valid?
(Hint: It is not valid because the object of the agreement is unlawful.)
 - v) A promises to give a gift of Rs. 10,000 to B on his marriage. A fails to keep his promise. Can B recover the money.
(Hint: B cannot recover the money because there is no consideration from B.)
 - vi) A agreed to sell a particular horse to B. Later on it was discovered that the horse was dead at the time of making the contract. Advise the parties.
(Hint: The contract is not valid because there is no consent. Both the parties were under a mistake of fact regarding existence of the subject-matter).

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.