

UNIT - 1

Fundamentals of Contract Law

Law of Contract is the most important and basic part of Mercantile law. It is the foundation for many other laws falling in the category of mercantile laws. It is not only the mercantile or trader but every person who lives in the organised society, consciously or unconsciously enters into contract from sunrise to sunset. When a person hires a taxi, or orders something in a hotel or buys something from a shop, purchases a newspaper, ride a bus etc. he actually enters into and performs contract though he may be unaware of this fact. Such contracts at times create legal relations giving rise to certain rights and obligations.

The law relating to contracts in India is contained in **Indian Contract Act, 1872**. The Act came into force with effect from September 1, 1872. It is applicable to the whole of India except the State of Jammu & Kashmir (**As per Section 1**).

SCHEME OF THE ACT: The Act as enacted originally had 266 Sections divided into following Chapters:

Chapters	Provisions	Sections
	Preliminary	S. 1 - 2
Ch. I	Communication, Acceptance and Revocation of Proposals	S. 3 - 9
Ch. II	Contracts, Voidable Contracts, and Void Agreements	S. 10 - 30
	Void Agreements	
Ch. III	Contingent Contracts	S. 31 - 36
Ch. IV	Performance of Contracts	S. 37 - 67
	Contracts which must be Performed	
	By whom contracts must be performed	
	Time and place for performance	
	Performance of Reciprocal Promises	
	Appropriation of payments	
	Contract which need not to be performed	
Ch. V	Certain Relations Resembling those created by Contract	S. 68 - 72
Ch. VI	The Consequences of Breach of Contract	S. 73 - 75
Ch. VII	Sale of Goods [Repealed by SALE OF GOOD ACT, 1930]	S.76-123
Ch. VIII	Indemnity and Guarantee	S. 124 - 147
Ch. IX	Bailment	S. 148 - 181
	Bailments of pledges	

	Suit by bailor or bailee against wrong-doer	
Ch. X	Agency Appointment and Authority of agents	S. 182 - 238
	Appointment and Authority of agents	
	Sub-agents	
	Ratification	
	Revocation of authority	
	Agent's duty to principal	
	Principal's duty to agent	
	Effect of agency on contracts with third persons	
Ch. XI	Of Partnership [Repealed by Indian Partnership Act, 1932]	S. 239 - 266 [Repealed]
Sch.	[Repealed]	[Repealed]

These sections were repealed from the Contract Act, 1872 and two new Acts were enacted for the same:

- * **SALE OF GOOD ACT, 1930**
- ** **PARTNERSHIP ACT, 1932**

PRESENT FORM OF INDIAN CONTRACT ACT

Law of Contract basically relates to the essentials of a valid contract, the rules for performance and discharge of a contract and the remedies available to the aggrieved party in cases of the breach of the contract.

The Indian Contract Act, in its present form may be divided into two parts-

- ⇒ The First part of the enactment i.e. Section 1 to 75 deals with the **general principles of the law of contract** which apply to all types of contracts irrespective of their nature.
- ⇒ The second part (i.e. Section 124 to 238) deals with special types of contracts namely indemnity and guarantee, bailment and pledge, agency etc.

Enforcement of Act: The Indian Contract Act was passed in 1872 and came into force from 1st September, 1872. Prior to this English law of contract was followed in India. Law of contract creates jus in personam and not jus in rem. It extends to whole of India except state of Jammu and Kashmir.

OBJECTIVE OF THE ACT: The objective of the Contract Act, 1872 is to ensure that the rights and obligations arising out of a contract are honoured and that legal remedies are made available to an aggrieved party against the party failing to honour his part of agreement. Act lays down the basic principles of the formation, performance and enforceability of contracts. Although, law of contract is not the whole law of agreements or that of obligations.

DEFINITIONS OF CONTRACT

POLLOCK

“Every agreement and promise enforceable at law is a contract.”

HALSBURY

“A contract is an agreement between two or more persons which is intended to be enforceable at law and is contracted by the acceptance by one party of an offer made to him by the other party to do or abstain from doing some act.”

SALMOND

“A contract is an agreement creating and defining obligation between the parties”

SIR WILLIAM ANSON

“A legally binding agreement made between two or more persons by which rights are acquired by one or more to acts or forbearances on the other or others.”

In essence, an agreement may be or may not be enforceable by law, and so all agreements are not contracts. Only those agreements are contracts, which are enforceable by law.

AGREEMENT + ENFORCEABILITY BY LAW = CONTRACT

Hence, it can be concluded that “All contracts are agreements, but all agreements are not contracts.”

DISTINCTION BETWEEN CONTRACT & AGREEMENT

BASIS OF DISTINCTION	CONTRACT	AGREEMENT
Section	Sec. 2(h)	Sec. 2(e)
Definition	A contract is an agreement enforceable by law.	Every promise or every set of promises forming consideration for each other is an agreement.
Enforceability	Every contract is enforceable	Every promise is not enforceable.
Inter-relationship	All contracts are necessarily agreements.	Every agreement need not necessarily be a contract.
Scope	The scope of a contract is limited, as it includes only commercial agreements.	Its scope is relatively wider, as it includes both social agreement and commercial agreements.

According to Section 10, **"All agreements are contract 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 expressly declared to be void."**

Simplifying the same, all agreements are contracts, if they are made-

- ⇒ by free consent of the parties,
- ⇒ competent to contract,
- ⇒ for a lawful consideration
- ⇒ with a lawful object, and
- ⇒ not hereby expressly declared to be void

Along with the elements mentioned under Section 10 there are certain other basic elements of a valid contract which may be mentioned as follows -

1. **Proper Offer and Acceptance:** There must be at least two parties- one making the offer and the other accepting it. Such offer and acceptance must be valid. An offer to be valid must fulfill certain conditions, such as it must intend to create legal relations, its terms must be certain and unambiguous, it must be communicated to the person to whom it is made, etc. An acceptance to be valid must fulfill certain conditions, such as it must be absolute and unqualified, it must be made in the prescribed manner and it must be communicated by an authorized person before the offer lapses.
2. **Intention to Create Legal Relationship:** The requirement of intention to create legal relations in contract law is aimed at sifting out cases which are not really appropriate for court action. Not every agreement leads to a binding contract which can be enforced through the courts. For example you may have an agreed to take a friend for a movie or for dinner. You may have a moral duty to honour that agreement but not a legal duty to do so. This is because in general the parties to such agreements do not intend to be legally bound and the law seeks to mirror the party's wishes. In order to determine which agreements are legally binding and have an intention to create legal relations, the law draws a distinction between social, moral, domestic and religious agreements and agreements made in a commercial context. There must be an intention among the parties to create a legal relationship. In case of social or domestic agreements, the usual presumption is that the parties do not intend to create legal relationship but in commercial or business agreements, the usual presumption is that the parties intend to create legal relationship unless otherwise agreed upon.

Example: X invited Y to a dinner Y accepted the invitation. It is a social agreement. If X fails to serve dinner to Y, Y cannot go to the courts of law for enforcing the agreement. Similarly, if Y fails to attend the dinner, X cannot go to the courts of law for enforcing the agreement.

RELEVANT CASES ON THIS POINT:

- **Rose & Frank Co. v. Crompton Bros. (1925)**
 - **Balfour v. Balfour (1919)**
3. **Capacity of Parties:** As per the requirement of Sec. 10, the parties to an agreement must be competent to contract. In other words, they must be capable or competent to enter into a contract. If either of the parties does not have the capacity to contract, the contract is not valid. According to **Section 11** of Indian Contract Act, 1872, **"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." Therefore, other way round, following persons are incompetent to contract-

- (a) Minors,
- (b) Persons of unsound mind, and
- (c) Persons disqualified by law to which they are subject.

So, the person to be competent to contract must be major, must be of sound mind and must not be declared disqualified from contracting by any law to which he is subject. If the parties to agreement are not competent to contract, then no valid contract comes into existence.

RELEVANT CASE: *Mohiri Bibi v. Dharmodas Ghosh* (Landmark case on minor's contract. Minor's contract has been held as void ab initio.)

4. **Lawful Consideration:** An agreement must be supported by lawful consideration. Consideration means something in return. In the words of Pollock, "Consideration is the price for which the promise of another is bought." Consideration is known as quid pro-quo i.e. something in return. Contract Act not only requires a consideration rather it prescribes for a lawful consideration. Now, what constitutes a lawful consideration has been explained under **Section 23** of the Indian Contract Act, 1872, according to which, "The consideration is considered lawful unless it is forbidden by law or is of such a nature that if permitted would defeat the provisions of any 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."

Example: A agrees to sell his car to B for Rs.1,00,000. Here B's promise to pay Rs.1,00,000 is the consideration for A's promise to sell the car and A's promise to sell the car is the consideration for B's promise to pay Rs.1,00,000.

5. **Lawful Object:** The object of an agreement must be lawful. According to **Section 23** of the Indian Contract Act, 1872, "the object is considered lawful unless-
- o it is forbidden by law;
 - o it is of such nature that if permitted it would defeat the provision of any law;
 - o it is fraudulent;
 - o it involves an injury to the person or property of any other;
 - o the court regards it as immoral or opposed to public policy."

Example: X, Y and Z enter into an agreement for the division among them of gains acquired or to be acquired by them by fraud. The agreement is void because its object is unlawful.

6. **Free Consent:** There must be free consent of the parties to the contract. Free consent of all the parties to a contract is one of the essential elements of a valid contract as per requirement of Section 10. The parties to a contract should have identity of minds. This is called consensus ad idem in English Law. Consent has been defined under **Sec. 13** of the Contract Act as follows- "Two or more person are said to consent when they agree upon the same thing in the same sense" (consensus ad idem). It means that there is no contract if the parties have not agreed upon the same thing in the same sense.

Further, Contract Act requires not only consent but a free consent. According to **Section 14**, consent is said to be free when it is not caused by-

- o **Coercion, or**

A. On the basis of creation or formation-

1. **Express Contracts:** An express contract is one entered into by words which may be either spoken or written. Where the proposal and acceptance is made in words, it is an express contract.
Example 1: A says to B, "Will you buy my furniture for Rs. 50,000?" B says to A, "I am ready to buy your car for Rs. 50,000." It is an express contract made orally.
Example 2: A writes a letter to B, I offer to sell my furniture to you for Rs. 50,000." B send a letter to A, "I am ready to buy your furniture for Rs. 50,000." It is an express contract made in writing.
2. **Implied Contracts:** Where the proposal or acceptance is made otherwise than in words, it is an implied contract. Implied contract can be inferred from the surrounding circumstances and the conduct of the parties who made them.
Example: A, a coolie in uniform picks up the baggage of B to carry it from railway platform to the taxi without being asked by B to do so and B allows it. In this case there is an implied offer by the coolie and an implied acceptance by the passenger. Now, there is an implied contract between the coolie and the passenger and the passenger is bound to pay for the services of the coolie.
3. **Quasi Contracts or constructive contracts:** It is contract in which there is no intention on either side to make a contract, but the law imposes a contract. In such a contract, rights and obligations arise not by any agreement between the parties but by operation of law. Thus, a finder of lost goods is under an obligation to find out the true owner and return the goods. Similarly, where certain goods are delivered to a wrong addressee, the addressee is under an obligation either to pay for them or return them.
4. **E. Com. Contracts/Contracts over Internet:** These contracts are entered into between the parties using internet. In electronic commerce, different parties/persons create network which are linked to other network through EDI (Electronic Data Inter-change). This helps in doing business transactions using electronic mode.

B. On the basis of validity or enforceability-

1. **Valid Contract:** An agreement enforceable at law is a valid contract as per Sec. 2(h). An agreement becomes a contract when all the essentials of a valid contract as laid down in Section 10 are fulfilled.
2. **Void Contract [Sec. 2(j)]:** The term 'Void contract' is a contradiction in terms. But according to **Section 2(j), "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable"** In other words, a void contract is a contract which was valid and legally enforceable when entered into but which subsequently became void due to supervening or subsequent impossibility of performance, change of law or some other reason.
3. **Void Agreements:** According to **Section 2(g), "An agreement which is not enforceable by law by either of the parties is void."** Such agreements are **void ab initio** i.e. they are unenforceable from the very inception. No legal rights or obligations can arise out of a void agreement. For example an agreement without consideration or with a minor is a void agreement. A void agreement never matures into a contract.

4. **Voidable Contract:** According to **Section 2(i)**, "**An agreement which is enforceable by law at the option of one or more of the parties thereto but not at the option of the other or others is a voidable contract.**" Note that the word used here is 'contract' and not just 'agreement'. This is the result of absence of free consent in the contract. The consent is said to be not free when it was obtained by coercion, undue influence, fraud, misrepresentation or mistake. The other party who although took a consent cannot be allowed to take advantage of his own fraud because this is a judicial principle that "***He who comes into equity (i.e. before law) must come with clean hands.***" Thus, a voidable contract is one which can be set aside or repudiated or avoided at the option of that aggrieved party whose consent was not free. Also, a voidable contract is valid and enforceable until it is repudiated (i.e. avoided) by the party entitled to avoid it.

[NOTE: As per **Section 64** of the Contract Act, in case of a voidable contract, if the aggrieved party decides to repudiate the contract, the party rescinding the contract must restore the benefit received by him under the contract to the person from whom the benefit was received and the other party is freed from his obligation to perform the contract. This is called "**RESTITUTION**")]

5. **Unenforceable Contract:** It is contract which is otherwise valid, but cannot be enforced because of some technical defects like absence of a written form or absence of a proper stamp. Such contracts cannot be proved in court. But, such contracts can be enforced if the technical defect involved is removed.
Example: An oral agreement for arbitration is unenforceable because the law requires that an arbitration agreement must be in writing. If the oral agreement for arbitration is reduced to writing, it will become enforceable.
6. **Illegal Agreements:** An illegal agreement is one the object of which is unlawful, or is prohibited by law or otherwise against the policy of law. Such agreements cannot be enforced by law. Illegal agreements are always void ab initio. Thus, a contract to commit dacoity is an illegal agreement and cannot be enforced at law.
- **EFFECT ON COLLATERAL AGREEMENT:** In case of illegal agreements, even the collateral agreements become void. Although an illegal agreement should be distinguished from a void contract. **All illegal agreements are void but all void agreements or contracts are not necessarily illegal.** Every void agreement is not illegal unless its object or consideration is immoral, or opposed to public policy etc. A void contract does not affect collateral or a parallel contract.

C. On the basis of execution or performance-

1. **Executed contracts:** An executed contract is one where both the parties have performed their respective obligations under the contract and nothing remains to be done by either party.
Example: A offers to sell his bike to B for Rs. 15,000. B accepts A's offer. A delivers his bike to B and B pays Rs. 15,000 to A. It is an executed contract.
2. **Executory Contract:** Where the contract is yet to be performed either wholly or partially or one or both parties have yet to perform their obligation, the contract is executory contract.
Example: A offers to sell his bike to B for Rs. 15,000. B accepts A's offer. If the bike has not yet been delivered by A and the price has not yet been paid by B, it is an executory contract.
3. **Partly Executed and Partly Executory Contract:** It is a contract where one of the parties to the contract has fulfilled his obligation and the other party has still to perform his obligation.

Example: A offers to sell his bike to B for Rs. 15,000 on a credit of one month. B accepts A's offer. A delivers his bike to B. Here, the contract is executed as to A and executory as to B.

D. On the basis of liability-

1. **Unilateral Contracts:** A unilateral contract is one in which a promise on one side is exchanged for an act on the other side. A contract is said to be unilateral where one party has discharged his obligation either before or at time of entering into contract.
2. **Bilateral Contracts:** These are the contract where a promise on one side is exchanged for a promise on the part of the other party.

DISTINCTION BETWEEN VOID AGREEMENT AND VOID CONTRACT

BASIS OF DISTINCTION	VOID AGREEMENT	VOID CONTRACT
1. DEFINITION	An agreement not enforceable by law is said to be void. [Sec. 2(g)]	A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable [Sec. 2(i)]
2. TIME WHEN BECOMES VOID	It is void from the very beginning. (void ab initio)	It becomes void subsequently due to change in law or change in circumstances.
3. RESTITUTION	Generally no restitution is granted, however, the Court may on equitable grounds grant restitution in case of fraud or misrepresentation.	Restitution may be granted when the contract is discovered to be void or becomes void.
4. DESCRIPTION IN THE ACT	Such agreements have been mentioned as void in the Act. Agreements without consideration, agreements with unlawful object or consideration and some other agreements have expressly been declared to be void.	There is no mention of cases of void contracts in the Act. They are created by circumstances and law Courts decide whether they have become void or not.

DISTINCTION BETWEEN VOID AGREEMENT AND VOIDABLE CONTRACT

BASIS OF DISTINCTION	VOID AGREEMENT	VOIDABLE CONTRACT
1. DEFINITION & ENFORCEABILITY	An agreement not enforceable by law is said to be void. It cannot be enforced by any party. It is a nullity and hence does not exist in the eye of law.	A contract enforceable by law at the option of the aggrieved party is a voidable contract. It continues to be enforceable if the aggrieved party does not repudiate the contract.
2. PERIOD OF VALIDITY	It is void from the beginning i.e. void ab initio	It is valid till it is avoided (or rescinded) by the aggrieved party to the contract.

3. CHANGE IN STATUS	Status of void agreement does not change with the change in circumstances.	Status of such contract change when the aggrieved party elects to avoid or rescind it within a reasonable time. It becomes void when the aggrieved party elects to rescind it.
4. CAUSES	An agreement is void because an essential element of a valid contract (other than free consent) is missing. Reasons may be that it was made with incompetent parties or for unlawful objects and consideration, or without consideration, or it is expressly declared to be void under the law.	A contract is voidable when the consent of the party is caused by coercion or undue influence or fraud or misrepresentation.
5. TRANSFER OF TITLE	The party obtaining goods under void agreement cannot transfer a good title to the third party.	The party obtaining goods under voidable agreement can transfer a good title to the third party if the third party obtains it in good faith and for consideration and the aggrieved party has not avoided the contract before such transfer.
6. RESTITUTION	Parties do not have right to restore the benefits passed on to the other unless the parties were unaware of the impossibility of performance at the time of agreement or the party to the agreement was minor.	Generally, right for restitution is available if the party elects to avoid the contract.
7. DAMAGES	No party has a right to get compensation for damages because such agreement has no legal effect.	If a party rightfully rescinds (i.e. puts and end) the contract, he can claim compensation, he can claim compensation of damages sustained by him due to non-fulfillment of the promise.

DISTINCTION BETWEEN VOID CONTRACT & VOIDABLE CONTRACT

BASIS OF DISTINCTION	VOID CONTRACT	VOIDABLE CONTRACT
1. DEFINITION	A contract which ceases to be enforceable by law become void, when it ceases to be enforceable.[Sec.2(j)]	A contract which is enforceable by law at the option of the aggrieved party is a voidable contract.
2. PERIOD OF VALIDITY	It remains valid till it does not cease to be enforceable.	It remains valid if the aggrieved party does not elect to avoid it within a reasonable time.
3. WILL OF THE PARTY	Its validity is not affected by the will of any party. It is decided by the law Court.	Its validity is affected by the will of the aggrieved party. Aggrieved party has option to treat it either binding or repudiate it.
4. CAUSES	Contracts become void due to change in circumstances or in the law of land.	Contract is voidable when the consent of the party is caused by coercion, undue influence, fraud or misrepresentation. Sometimes, it may be voidable under the provisions of the Sections 39, 53 and 55.

DISTINCTION BETWEEN VOID AND ILLEGAL AGREEMENT

BASIS OF DISTINCTION	VOID AGREEMENT	ILLEGAL AGREEMENT
1. DEFINITION	An agreement not enforceable by law is void.	An agreement which is expressly or impliedly prohibited by law is illegal.
2. EFFECT ON COLLATERAL AGREEMENT	The agreement collateral to the void agreement is not necessarily void.	The agreement collateral to an illegal agreement is always void.
3. SCOPE	All void agreements need not necessarily be illegal agreements. Hence, the scope is wider than that of the illegal agreements.	All illegal agreements are void.
4. RESTITUTION	The Court may grant restitution of money advanced if is minor or if the parties were unaware of the impossibility of performance of the agreement.	Restitution of money is not granted in case of an illegal agreement.