

CHAPTER 2
CONTRACT LAWS
INDIAN CONTRACT ACT, 1872

Definition of Contract

A contract is an agreement made between two or more parties which the law will enforce.

Sec 2(h) defines contract “as an agreement enforceable by law”.

Contract=Agreement + Enforceability at law.

Agreement

Agreement is defined as “every promise and every set of promises, forming consideration for each other”.

Promise= a proposal when accepted becomes a promise.

Agreement = Offer+ Acceptance

Consensus Ad Idem

The parties to the agreement must have agreed about the subject matter of the agreement in the same sense and at the same time.

Unless there is consensus ad idem, there can be no contract.

Enforceable by law

An agreement, to become a contract, must give rise to a legal obligation or duty.

An agreement may be social agreement or legal agreement.

But only those agreements which are enforceable in a court of law are contracts.

“All contracts are agreements, but all agreements are not necessarily contract”

Essential elements of a Valid Contract

1. Offers and Acceptance
2. Legal Relationship
3. Lawful Consideration
4. Capacity of Parties
5. Free Consent
6. Lawful Objects
7. Writing and Registration
8. Certainty
9. Possibility of Performance
10. Not Expressly Declared Void

1. Offers and Acceptance

It is one of the essentials of valid contract. There must be an offer and acceptance of the same.

2. Legal Relationship

The parties to an agreement must create legal relationship. Agreements of a social or domestic nature do not create legal relations and as such cannot give rise to a contract. 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.

3. Lawful Consideration

Consideration is “something in return.” Consideration has been defined as the price paid by one party for the promise of the other.

Example, X agrees to sell his motor bike to Y for Rs. 1,00,000. Here Y’s promise to pay Rs. 1,00,000 is the consideration for X’s promise to sell the motor bike and X’s promise to sell the motor bike is the consideration for Y’s promise to pay 1,00,000.

4. Capacity of Parties

It means that the parties to an agreement must be competent to contract. A contract by a person of unsound mind is void ab-initio. Thus, a contract entered into by a minor or by a lunatic is void.

Example: X a minor borrowed Rs 8,000 from Y and executed mortgage of his property in favour of the lender. This was not a valid contract because X is not competent to contract.

5. Free Consent

For a valid contract it is necessary that the consent of parties to the contract must be free.

Example: X threatens to kill Y if he does not sell his car to X. Y agrees to sell his car to X. In this case, Y’s consent has been obtained by coercion and therefore, it cannot be regarded as free.

6. Lawful Objects

It is also necessary that agreement should be made for a lawful object. Every agreement of which the object or consideration is unlawful is illegal and therefore void.

7. Writing and Registration

According to Contract Act, a contract may be oral or in writing. Although in practice, it is always in the interest of the parties that the contract should be made in writing so that it may be convenient to prove in the court.

8. Certainty

For a valid contract, the terms and conditions of an agreement must be clear and certain.

9. Possibility of Performance

If the act is legally or physically impossible to perform, the agreement cannot be enforced at law.

Example: A agrees with B to discover treasure by magic and B agrees to pay Rs 1,000 to A. This agreement is void because it is an agreement to do an impossible act.

10. Not Expressly Declared Void

An agreement must not be one of those, which have been expressly declared to be void by the Act.

Kinds of Contracts

Contracts may be classified as follows:

1. On the basis of enforceability

- (a) Valid Contracts.
- (b) Void Contracts.
- (c) Voidable Contracts.
- (d) Illegal Contracts.
- (e) Unenforceable Contracts.

2. On the basis of mode of creation

- (a) Express Contracts.
- (b) Implied Contracts.

3. On the basis of the extent of execution.

- (a) Executed Contracts.
- (b) Executory Contracts.

Valid contract: The Contracts which are enforceable in a court of law are called Valid Contracts.

Voidable Contract: If one party to the contract has the option of enforcing a contract by law, but not at the option of the other or others, it is a voidable contract.

Void contract: An agreement may be enforceable at the time when it was entered into but later on, due to certain reasons, for example impossibility or illegality of the contract, it may become void and unenforceable.

Illegal contract: If the contract has unlawful object it is called Illegal Contract.

Example: There is a contract between X and Z according to which Z has to murder Y for a consideration of Rs. 10000/- from X. It is illegal contract.

Unenforceable contract: A contract which has not properly fulfilled legal formalities is called unenforceable contract. That means unenforceable contract suffers from some technical defect like insufficient stamp etc. After rectification of that technical defect, it becomes enforceable or valid contract.

Example: A and B have drafted their agreement on Rs. 10/- stamp where it is to be written actually on Rs. 100/- stamp. It is unenforceable contract.

All illegal Contracts are void, but all void contracts are not illegal

Express contract – Where the offer or acceptance of any promise is made in words, the promise is said to be express. For example: A has offered to sell his house and B has given acceptance. It is Express Contract.

Implied contract – An implied contract is one which is inferred from the acts of the parties or course of dealings between them. Sitting in a Bus can be taken as example to implied contract between passenger and owner of the bus.

Quasi Contract: In case of Quasi Contract there will be no offer and acceptance so, actually there will be no Contractual relations between the partners. Such a Contract which is created by Virtue of law is called Quasi Contract.

Executed contract - In a contract where both the parties have performed their obligation.

Unilateral contract - In a contract one party has performed his obligation and other person is yet to perform his obligation.

Bilateral contract – It is a contract where both the parties are yet to perform their obligation. Bilateral & Executory are same and inter - changeable.

OFFER

Definition of Offer

When a person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence he is said to make a proposal. - Section 2 (a) of Indian Contract act.

Legal Rules Regarding Valid Offer

A valid offer must be in conformity with the following rules:

The offer must be capable of creating legal relationship: If the offer does not intend to give rise to legal consequences, it is not a valid offer in the eyes of law.

2. The terms of the offer must be clear, definite and certain and not loose or vague: An offer must be definite and certain.
3. An offer must be distinguished from a mere declaration of intention: Sometimes there may be preliminary discussion or an invitation by one party to the other to negotiate terms or simply declaration of intention. Such declaration merely indicates that an offer will be made in future.
4. An invitation to offer is not an offer: An offer must be distinguished from an 'invitation to receive offer'. The offeror should, express his willingness to do or abstain from doing something with such finality that the only thing wanted is the assent of the other party. But where a party proposes certain terms on which he is willing to negotiate, he is not making an offer but only inviting others to make offer on those terms.
5. An offer must be communicated to the offer: An offer must be communicated to the person to whom the same is addressed.
6. An offer should not contain such a term the non-compliance of which would amount to acceptance: The offeror cannot say that if the offer does not communicate acceptance by a certain time the offer would have been deemed to be accepted. The burden of communication of rejection of offer cannot be imposed on the offeree. If the offeree sends no reply, there is no contract.
7. Two identical cross - Where two parties make identical offers to each other, in ignorance of each other's offer, the offers are known as cross offers. 'Cross offers' do not constitute acceptance of one's offer by the other and as such there is no completed agreement.

ACCEPTANCE

Definition of Acceptance

When the person to whom the proposal is made, signifies his ascent there to, the proposal (offer) is said to be accepted. A proposal (offer) when accepted becomes a Promise.

Essentials of Valid Acceptance

1. Acceptance must be given by that person only to whom the offer is made:

An acceptance to be valid must be given only by a person to whom offer has been given. In other words, acceptance must move from the offeree and no one else.

2. Acceptance must be communicated:

Offeree has to communicate his acceptance to offerer.

3. The acceptance must be given within the time prescribed or within a reasonable time:

Sometimes, the time limit is fixed within which an acceptance is to be given. In such cases, the acceptance must be given within the fixed time limit. In case, no time is prescribed, the acceptance should be given within a reasonable time. The term 'reasonable time' depends upon the facts and circumstances of each case.

4. Acceptance must be Un-Conditional:

It is another important essential element of a valid acceptance. A valid contract arises only if the acceptance is absolute and unconditional. It means that the acceptance should be in total and without any condition.

6. Acceptance must be communicated in the method specified by offerer:

When an offer is made for the same, acceptance must be communicated in the method specified by offerer.

7. The acceptance must be given before the lapse of offer:

A valid contract can arise only when the acceptance is given before the offer has elapsed or withdrawn. An acceptance which is made after the withdrawal of the offer is invalid, and does not create any legal relationship

8. The acceptance must be communicated:

It is an important and essential element of a valid acceptance.

CONSIDERATION

When a party to an agreement promises to do something, he must get “something” in return. This “something” is defined as consideration.

The essentials or legal rules of a valid consideration are as under:-

1. It must move at the desire of the promisor:

In order to constitute legal consideration the act or abstinence forming the consideration for the promise must be done at the desire or request of the promisor.

Example:

X saves Y's house from the fire without being asked to do so. X cannot demand payment for his services because X performed this act voluntarily and not at the desire of Y.

2. It may move from the Promisee or any other person:

The second essential of a valid consideration is that consideration may move from the promisee or from a third person on his behalf.

[Chinnaya v. Ramayya]

3. It may be past, present or future:

Consideration may be past present or future.

A) Past Consideration:

When the consideration for a present promise was given before the date of the promise it is called a past consideration. It is not a valid consideration.

B) Present Consideration:

When consideration is given simultaneously by one party to another at the time of contract, it is called Present Consideration. The act constituting the consideration is wholly or completely performed.

Example:

A sells a book to B and B pay its price immediately it is a case of present consideration.

C) Future Consideration:

When the consideration on both sides is to be given at a future date, it is called future consideration or executory consideration. It consists of promises and each promise is a consideration for the other.

4. It need not be Adequate:

It is not necessary that consideration should be adequate to the value of the promise. The law only insists on the presence of consideration and not on its adequacy. It is for the parties to the contract to consider the adequacy of consideration and the courts are not concerned about it.

Example:

A agrees to sell his car worth Rs.20000 for Rs.5000 only and his consent is free. The agreement is valid contract.

5. It must be real:

It is necessary that consideration must be real and competent.

Example:

A promise to put life in X's dead body on B's promise to pay him Rs.1000. It is not real.

CAPACITY TO CONTRACT

Section 10 requires that the parties shall be competent to contract.

Section 11- Who are competent to contract.-

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.

Person's incompetent to contract

- Minor
- Persons of unsound mind

MINORS

According to Indian Majority Act, 1875, a person attains majority on completion of 18 years of his age. But when a guardian of a minor person or property has been appointed by the court, he attains majority on completion of 21 years of age.

Mohoribibi v. Dharmadas Ghose

HELD: Minor's agreement is void ab initio

The position of Minor's agreement and effect thereof is as under;

- (a) An agreement with a minor is **void ab-initio**.
- (b) **The law of estoppels does not apply against a minor.** It means a minor can always his plead his minority despite earlier misrepresenting to be a major. In other words he cannot be held liable on an agreement on the ground that since earlier he had asserted that he had attained majority.
- (c) **Doctrine of Restitution** does not apply against a minor i.e., As per section 70 Obligation of person enjoying benefit of non-gratuitous act does not apply.
- (d) **Ratification of agreement is not permitted:** Ratification means approval or confirmation. A minor cannot confirm an agreement made by him during minority on attaining majority. If he wants to ratify the agreement, a fresh agreement and fresh consideration for the new agreement is required.
- (e) **Contract beneficial to Minor;** A minor is entitled to enforce a contract which is of some benefit to him. Minority is a personal privilege and a minor can take advantage of it and bind other parties.
- (f) **Minor as an agent.** A minor can be appointed an agent, but he is not personally liable for any of his acts.
- (g) **Minor's liability for necessities:** "Any person supplying necessities of life to persons who are incapable of contracting is entitled to claim the price from the other's property".

SOUND MIND FOR THE PURPOSES OF CONTRACTING: (Section 12)

A person is said to be of sound mind for the purposes of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests.

- A person, who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind.
- A person, who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

Other Disqualified Persons

The persons who are disqualified from entering into contract due to certain other reasons may be from legal status, political status or corporate status. Some of such categories of persons are given below;

1. **Alien Enemy:** An agreement with an Alien Enemy is void.
2. **Foreign Sovereign and Ambassadors:** Foreign sovereigns and their representatives enjoy certain privileges and immunities in every country. They cannot enter into contract except through their agents residing in India.
3. **Convicts:** A convict cannot enter into a contract while he is undergoing imprisonment.
4. **Insolvents:** An insolvent person is one who is unable to discharge his liabilities and therefore has applied for being adjudged insolvent or such proceedings have been initiated by any of his creditors. An insolvent person cannot enter into any contract relating to his property.
5. **Company or Statutory bodies:** A contract entered into by a corporate body or statutory body will be valid only to the extent it is within its Memorandum of Association

FREE CONSENT

According to Sec 10 of the Indian Contract Act one of the essentials of a valid contract is “Free Consent”

Sec 13 defines “consent” as “Two or more persons are said to consent when they agree upon the same thing in the same sense”. According to Sec 14, consent is said to be free when it is not caused by:

1. Coercion
2. Undue influence
3. Fraud
4. Misrepresentation
5. Mistake

COERCION

According to Sec 15 coercion means “Committing or threaten to commit any act forbidden by Indian Penal Code or unlawful detaining or threatening to detain any other persons property with a view to enter into an agreement.

Effect of Coercion- When the consent of a party to an agreement is obtained by coercion; the contract becomes voidable at the option of the party, whose consent is so obtained. The burden of proving that the consent was obtained through coercion shall be upon the party who wants to set aside the contract on the plea of contract.

UNDUE INFLUENCE

Sometimes a party is compelled to enter into a contract against his will as a result of unfair persuasion by the other party.

Section 16 defines undue influence as follows

A contract is said to be induced by “undue influence”, where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

Analyzing the provision of Section 16(1), we get the following essential features –

- i) A relation subsists between the parties whereby one of them is in a position to dominate the will of the other,
- ii) The dominant party uses his superior position to obtain an unfair advantage over the other.

FRAUD

Misrepresentation of facts may be intentional or innocent. Intentional misrepresentation has been termed as Fraud and innocent misrepresentation has been termed simply as 'misrepresentation' in the contract act.

The essentials of fraud are:

1. There must be a representation or assertion and it must be false
2. The representation must relate to a fact
3. The representation must have been made with the intention of inducing the other party to act upon it
4. The representation must have been made with a knowledge of its falsity
5. The other party must have subsequently suffered some loss

MISREPRESENTATION

Misrepresentation is a false representation made innocently without any intention of deceiving the other party. It may include two things:

- (a) Wrong statement of a material fact not known to be false
- (b) Non-disclosure of facts where there is a legal duty to disclose without intention to deceive

MISTAKE

Mistake

Mistake are of two type

- (a) Mistake of law
- (b) Mistake of fact

Mistake of law

Mistake of law is further divided into three categories

- (a) Mistake of Indian law
- (b) Mistake of foreign law
- (C) Mistake as to private rights of the parties – treated as mistake of fact. Here, the agreement will be void in case of bilateral mistake only.

Mistake of fact

- i) Bilateral mistake
- ii) Unilateral mistake

DISCHARGE OF CONTRACT

Discharge by Performance

Discharge by Agreement or Consent

Discharge by Impossibility of Performance

Discharge by Lapse of Time

Discharge by Operation of Law

Discharge By Breach Of Contract

DISCHARGE BY PERFORMANCE

ACTUAL PERFORMANCE

When both the parties perform their promises.

ATTEMPTED PERFORMANCE

When the promisor offers to perform his obligation, but promisee refuses to accept the performance. It is also known as tender.

DISCHARGE BY AGREEMENT OR CONSENT

NOVATION (Sec 62): New contract substituted for old contract with the same or different parties.

RESCISSION (Sec 62) : When some or all terms of a contract are cancelled

ALTERATION (Sec 62): When one or more terms of a contract is/are altered by the mutual consent of the parties to the contract

REMISSION (Sec 63) :Acceptance of a lesser fulfillment of the promise made.

WAIVER: Mutual abandonment of the right by the parties to contract

MERGER: When an inferior right accruing to a party to contract merges into a superior right accruing to the same party

DISCHARGE BY IMPOSSIBILITY OF PERFORMANCE

- Known To Parties
- Unknown To Parties
- Subsequent Impossibility
- Supervening Impossibility (Sec 56)

- Destruction of subject matter
- Non-existence of state of things
- Death or incapacity of personal services
- Change of law
- Outbreak of war

DISCHARGE BY LAPSE OF TIME

The limitation act 1963, clearly states that a contract should be performed within a specified time called period of limitation

If it is not performed and if the promisee takes no action within the limitation time, then he is deprived of his remedy at law.

DISCHARGE BY OPERATION OF LAW

- Death
- Merger
- Insolvency
- Unauthorized Alteration Of The Terms Of A Written Agreement
- Rights & Liabilities Vesting In The Same Person

DISHARGE BY BREACH OF CONTRACT

ACTUAL BREACH:

- At the time of performance
- During the performance

ANTICIPATORY BREACH

- By the act of promisor (implied repudiation)
- By renunciation of obligation (express repudiation)

REMEDIES OF INJURED PARTY

A remedy is a means given by law for the enforcement of a right

Following are the remedies

[1] Rescission

[2] Suit upon damages

[3] Suit upon quantum meruit

[4] Suit for specific performance

[5] Suit for injunction

Rescission

When a contract is broken by one party, the other party may sue to treat the contract as rescinded and refuse further performance.

In such a case, he is absolved of all his obligations under the contract.

The court may give rescission due to

- 1) Contract is voidable
- 2) Contract is unlawful

Damages

Damages are monetary compensation allowed to the injured party by the court for the loss or injury suffered by him by the breach of a contract.

Types of Damages:

1. Ordinary Damages
2. Special Damages
3. Vindictive Damages
4. Nominal Damages
5. Liquidated Damages

Suit upon quantum meruit

The phrase quantum meruit literally means 'as much as earned'. A right to sue on a quantum meruit arises when a contract, partly performed by one party, has been discharged by breach of contract by the other party. This right is performed not on original contract but on implied promise by other party for what has been done.

Suit for specific performance

In certain cases of breach of contract damages are not an adequate remedy. The court may, in such cases, direct the party in breach to carry out his promise according to terms of the contract. This is a direction by the court for specific performance of the contract at the suit of the party not in breach.

Suit for injunction

When a party is in breach of a negative term of contract the court may, by issuing an order, restrain him by doing what he promised him not to do. Such an order of the court is called injunction.