

## INTRODUCTION

### **The Law of Contract**

The law of contract is that branch of law which determines the circumstances in which promises made by the parties to a contract shall be legally binding on them. Business law is of particular importance to people engaged in trade, commerce and industry as bulk of their business transactions are based on contracts.

### **THE INDIAN CONTRACT ACT, 1872:**

The law of contract is contained in the Indian Contract Act, 1872 which-

- (a) Deals with the general principles of law governing all contracts, (Secs.1 to 75)
- (b) Some special contracts only (Secs.124 to 238)

Law of contract creates jus in personam as distinguished from jus in rem:

Jus in rem means a right against or in respect of a thing: jus in personam means a right against or in respect of a specific person. Jus in rem is available against the world at large; jus in personam is available only against particular persons.

Examples:

a. X owes a certain sum of money to Y. Y has a right to recover this amount from X.

This right can be exercised only by Y and by none else against X. This right of Y is a jus in personam.

b. A is the owner of a house. He has a right to have quiet possession and enjoyment of that house against every member of the public. Similarly every member of the public is under an obligation not to disturb A's possession or enjoyment. This right of A is a jus in rem.

### **Meaning of Contract**

According to Section 2(h) of the Indian Contract Act, 1872, "An agreement enforceable by law is a contract." In other words, an agreement which can be enforced in a court of law is known as a contract. A contract must have the following two elements.

- a. An agreement, and
- b. Its enforceability by law.

Sir William Anson defines a contract as, "a legally binding agreement between two or more persons by which rights are acquired by one or more to acts or forbearances (Abstaining from doing something) on the part of the others".

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Pollock defines a contract as, “every agreement and promise enforceable at law is a contract”.

Agreement + Enforceability by law = Contract

### **Agreement**

According to Section 2(e) of the Indian Contract Act, 1872, “Every promise and every set of promises forming the consideration for each other is an agreement.” A proposal when accepted becomes a promise.

Offer + Acceptance = Agreement

### **Enforceability of Agreement**

An agreement is said to be enforceable by law if it creates some legal obligation. The parties to an agreement must be bound to perform their promises and in case of default by either of them, must intend to sue. E.g., in case of social or domestic agreements, the usual presumption that the parties do not intend to create legal relations.

### **Consensus ad idem**

The essence of an agreement is the meeting of the minds of the parties in full and final agreement: there must, in fact, be consensus ad idem. This means that 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.

### **Agreement is a very wide term**

An agreement may be a social agreement or a legal agreement. If A invites B to a dinner and B accepts the invitation, it is a social agreement. A social agreement does not give rise to contractual obligations and is not enforceable in a Court of law. It is only those agreements which are enforceable in a Court of law which are contracts.

Examples:

(a) An invite his friend B to come and stay with him for a week. B accepts the invitation but when he comes to A, A cannot accommodate him as his wife had died the day before. B cannot claim any compensation from A as the agreement is a social one.

(b) A father promises to pay his son Rs. 500 every month as pocket allowance. Later he refuses to pay. The son cannot recover as it is a domestic agreement and there is no intention on the part of the parties to create legal relations.

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To conclude: Contract = Agreement + Enforceability at law.

Thus, all contracts are agreements but all agreements are not necessarily contracts.

### **ESSENTIAL ELEMENTS OF A VALID CONTRACT:**

According to Sec. 10, all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void.

In order to become a contract, an agreement must have the following essential elements:

1. **Minimum two persons:** There must be at least two persons for a contract to come into existence. One person to make the offer and the other person to accept it.
2. **Offer and acceptance:** There must be two parties to an agreement, i.e., one party making the offer and other party accepting it. The terms of the offer must be definite and the acceptance of the offer must be absolute and unconditional. The acceptance must also be according to the mode prescribed and must be communicated to the offeror.
3. **Intention to create legal relationship:** When the two parties enter into an agreement, their intention must be to create legal relationship between them. If there is no such intention on the part of the parties, there is no contract between them. Agreements of a social or domestic nature do not contemplate legal relationship, as such they are not contracts.

Example: A husband promised to pay his wife a household allowance of £ 30 every month. Later the parties separated and the husband failed to pay the amount. The wife sued for the allowance. Held, agreements such as these were outside the realm of contract altogether [Balfour vs. Balfour, (1919) 2 K.B. 571]

4. **Lawful consideration:** An agreement to be enforceable by law must be enforceable by consideration. 'Consideration' means an advantage or benefit moving from one party to the other. It is the essence of a bargain. In simple words, it means 'something in return'. The agreement is legally enforceable only when both the parties give something and get something in return. A promise to do something, getting nothing in return is usually not enforceable by law. Consideration need not necessarily be in cash or kind. It may be an act or abstinence (abstaining from doing something) or promise to do or not to do something. It may be past, present or future. But it must be real and lawful. [Secs. 2 (d), 23 and 25).

5. **Capacity of parties – competency:** The parties to the agreement must be capable of entering into a valid contract. Every person is competent to contract if he (a) is of the age of majority, (b) is of sound mind, and (c) is not disqualified from contracting by any law to which he is subject (Secs. 11 and 12).

6. **Free and genuine consent:** It is essential to the creation of every contract that there must be free and genuine consent of the parties to the agreement. The consent of the parties is said to be free when they are of the same mind on all the material terms of the contract. The parties are said to be of the same mind when they agree about the subject-matter of the contract in the same sense and at the same time (Sec. 13). There is absence of free consent if the agreement is induced by coercion, undue influence, fraud, misrepresentation, etc. (Sec. 14).

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7. Lawful object: The object of the agreement must be lawful. In other words, it means that the object must not be (a) illegal, (b) immoral, or (c) opposed to public policy (Sec. 23). If an agreement suffers from any legal flaw, it would not be enforceable by law.

8. Agreement not declared void: The agreement must not have been declared void by law in force in the country (Secs. 24 to 30 and 56).

9. Certainty and possibility of performance: The agreement must be certain and not vague or indefinite (Sec. 29). If it is vague and it is not possible to ascertain its meaning, it cannot be enforced.

Examples: (a) A agrees to sell to B "a hundred tons of oil". There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty. (b) O agreed to purchase a motor van from S "on hire-purchase terms". The hire-purchase price was to be paid over two years. Held, there was no contract as the terms were not certain about rate of interest and mode of payment. No precise meaning could be attributed to the words "on hire-purchase" since there was a wide variety of hire-purchase terms.

10. Legal formalities: A contract may be made by words spoken or written. As regards the legal effects, there is no difference between a contract in writing and a contract made by word of mouth. It is, however, in the interest of the parties that the contract should be in writing. There are some other formalities also which have to be complied with in order to make an agreement legally enforceable. In some cases, the document in which the contract is incorporated is to be stamped. In some other cases, a contract, besides being a written one, has to be registered.

### **CLASSIFICATION OF CONTRACTS:**

Contracts may be classified according to their (1) validity, (2) formation, or (3) performance.

#### **I. Classification according to validity:**

A contract is based on an agreement. An agreement becomes a contract when all the essential elements referred to above are present. In such a case, the contract is a valid contract. If one or more of these elements is/are missing, the contract is either voidable, void, illegal or unenforceable.

1. Voidable contract: 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 [Sec. 2(i)]. This happens when the element of free consent in a contract is missing. When the consent of a party to a contract is not free, i.e., it is caused by coercion, undue influence, misrepresentation or fraud, the contract is voidable at his option. The party whose consent is not free may either rescind (avoid or repudiate) the contract if he so desires, or elect to be bound by it. A voidable contract continues to be valid till it is avoided by the party entitled to do so. Example: A promises to sell his car to B for Rs 2,00,000. His consent is obtained by use of force. The contract is voidable at the option of A. He may avoid the contract or elect to be bound by it. A contract becomes voidable in the following two cases also: i. When a person promises to do something for another person for a consideration but the other person prevents him from performing his promise, the contract becomes voidable at his option (Sec. 53).

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ii. When a party to a contract promises to perform an obligation within a specified time, any failure on his part to perform his obligation within the specified time makes the contract voidable at the option of the promisee (Sec. 55, Para 1).

When a person at whose option a contract is voidable rescinds it, the other party thereto need not perform any promise therein contained in which he is promisor. If the party rescinding the contract has received benefit under the contract from another party to such contract he shall restore such benefit, so far as may be, to the person from whom it was received (Sec. 64). The party rightfully rescinding the contract is also entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract (Sec. 65).

### 2. Void agreement and void contract:

(i) Void agreement: An agreement not enforceable by law is said to be void [Sec. 2 (g)]. A void agreement does not create any legal rights or obligations. It is a nullity and is destitute of legal effects altogether. It is void ab initio. i.e., from the very beginning as, for example, an agreement with a minor or an agreement without consideration.

(ii) Void contract: A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable [Sec. 2 (j)]. A contract, when originally entered into, may be valid and binding on the parties, e.g., a contract to import goods from a foreign country. It may subsequently become void, e.g., when a war breaks out between the importing country and the exporting country. It is illogical to talk of a void contract originally entered into, for what is supposed to be a contract is no contract at all.

(iii) Illegal agreement: An illegal agreement is one which transgresses some rule of basic public policy or which is criminal in nature or which is immoral. Such an agreement is a nullity and has much wider import than a void contract. All Illegal agreements are void but all void agreements or contracts are not necessarily illegal. An illegal agreement is not only void as between the immediate parties, but has this further effect that even the collateral transactions to it become tainted with illegality. A collateral transaction is one which is subsidiary, incidental or auxiliary to the principal or original contract.

3. Unenforceable contract: An unenforceable contract is one which cannot be enforced in a Court of law because of some technical defect such as absence of writing or where the remedy has been barred by lapse of time. The contract may be carried out by the parties concerned; but in the event of breach or repudiation of such a contract, the aggrieved party will not be entitled to the legal remedies.

## II. Classification according to formation

A contract may be (a) made in writing or by word of mouth, or (b) inferred from the conduct of the parties or the circumstances of the case. These are the modes of formation of a contract.

1. Express contract: If the terms of a contract are expressly agreed upon (whether by words spoken or written) at the time of formation of the contract, the contract is said to be an express contract. Where the offer or acceptance of any promise is made in words, the promise is said to be express (Sec. 9). An express promise results in an express contract.

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2. Implied contract: An implied contract is one which is inferred from the acts or conduct of the parties or course of dealings between them. It is not the result of any express promises by the parties but of their particular acts. It may also result from a continuing course of conduct of the parties. Where the proposal or acceptance of any promise is made otherwise than in words, the promise is said to be implied (Sec. 9). An implied promise results in an implied contract. Examples: a. there an implied contract when A – i. takes a cup of tea in a restaurant, ii. gets in to a public bus, iii. obtains a ticket from an automatic weighing machine, or iv. lifts B's luggage to be carried out of the railway station b. A fire broke out in P's farm. He called upon the Upton Fire Brigade to put out the fire which the latter did. P's farm did not come under the free service zone although he believed to be so. Held, he was liable to pay for the service rendered as the service was rendered on an implied promise to pay [Upton Rural District Council vs. Powell (1942) All E.R. 220].

3. Quasi-contract: Strictly speaking, a quasi-contract is not a contract at all. A contract is intentionally entered into by the parties. A quasi-contract, on the other hand, is created by law. It resembles a contract in that a legal obligation is imposed on a party who is required to perform it. It rests on the ground of equity that "a person shall not be allowed to enrich himself unjustly at the expense of another." Example: X, a tradesman, leaves goods at C's house by mistake. C treats the goods as his own. C is bound to pay for the goods.

4. E-Commerce contract: An E-commerce contract is one which is entered into between two parties via Internet. In Internet, different individuals or companies create networks which are linked to numerous other networks. This expands the area of operation in commercial transactions for any person.

### **III. Classification according to performance**

To the extent to which the contracts have been performed, these may be classified as -

1. Executed contract: 'Executed' means that which is done. An executed contract is one in which both the parties have performed their respective obligations. Example: A agrees to paint a picture for B for Rs. 1,000. When A paints the picture and B pays the price, i.e., when both the parties perform their obligations, the contract is said to be executed. In some cases, even though a contract may appear to be completed at once, its effects may still continue. Thus when a person buys a bun containing a stone and subsequently breaks one of his teeth, he has a right to recover damages from the seller [Chaproniere vs. Mason, (1905) 21 T.L.R 633].

2. Executory contract: 'Executory' means that which remains to be carried into effect. An executory contract is one in which both the parties have yet to perform their obligations. Thus, in the example, the contract is executory if A has not yet painted the picture and B has not paid the price. Similarly, if A agrees to engage B as his servant from the next month, the contract is executory.

### **Another classification of contracts according to the performance is as follows:**

1. Unilateral or one-sided contract: A unilateral or one-sided contract is one in which only one party has to fulfil his obligation at the time of the formation of the contract, the other party having fulfilled his obligation at the time of the contract or before the contract comes into existence. Such contracts are also known as contracts with executed consideration.

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Example: A permits a railway coolie to carry his luggage and place it in a carriage. A contract comes into existence as soon as the luggage is placed in the carriage. But by that time the coolie has already performed his obligation. Now only A has to fulfil his obligation, i.e., pay the reasonable charges to the coolie.

2. Bilateral contract: A bilateral contract is one in which the obligations on the part of both the parties to the contract are outstanding at the time of the formation of the contract. In this sense, bilateral contracts are similar to executory contracts and are also known as contracts with executory consideration.

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