CHAPTER

LAW OF CONTRACTS
We enter into contracts day after day. Taking a seat in a bus amounts to entering into a contract. When you put a coin in the slot of a weighing machine, you have entered into a contract. You go to a restaurant and take snacks, you have entered into a contract. In such cases, we do not even realise that we are making a contract. In the case of people engaged in trade, commerce and industry, they carry on business by entering into contracts. The law relating to contracts is to be found in the Indian Contract Act, 1872.

The law of contracts differs from other branches of law in a very important respect. It does not lay down so many precise rights and duties which the law will protect and enforce; it contains rather a number of limiting principles, subject to which the parties may create rights and duties for themselves, and the law will uphold those rights and duties. Thus, we can say that the parties to a contract, in a sense make the law for themselves. So long as they do not transgress some legal prohibition, they can frame any rules they like in regard to the subject matter of their contract and the law will give effect to their contract.

Section 2(h) of the Indian Contract Act, 1872 defines a contract as an agreement enforceable by law. Section 2(e) defines agreement as “every promise and every set of promises forming consideration for each other.” Section 2(b) defines promise in these words: “When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted, becomes a promise.”

From the above definition of promise, it is obvious that an agreement is an accepted proposal. The two elements of an agreement are:

(i) offer or a proposal; and
(ii) an acceptance of that offer or proposal.

What agreements are contracts? All agreements are not studied under the Indian Contract Act, as some of them are not contracts. Only those agreements which are enforceable at law are contracts. The Contract Act is the law of those agreements which create obligations, and in case of a breach of a promise by one party to the agreement, the other has a legal remedy. Thus, a contract consists of two elements:

(i) an agreement; and
(ii) legal obligation, i.e., it should be enforceable at law.

However, there are some agreements which are not enforceable in a law court. Such agreements do not give rise to contractual obligations and are not contracts.

Examples

(1) A invites B for dinner in a restaurant. B accepts the invitation. On the appointed day, B goes to the restaurant. To his utter surprise A is not there. Or A is there
but refuses to entertain B. B has no remedy against A. In case A is present in the restaurant but B fails to turn-up, then A has no remedy against B.

(2) A gives a promise to his son to give him a pocket allowance of Rupees one hundred every month. In case A fails or refuses to give his son the promised amount, his son has no remedy against A.

In the above examples promises are not enforceable at law as there was no intention to create legal obligations. Such agreements are social agreements which do not give rise to legal consequences. This shows that an agreement is a broader term than a contract. And, therefore, a contract is an agreement but an agreement is not necessarily a contract.

What obligations are contractual in nature? We have seen above that the law of contracts is not the whole law of agreements. Similarly, all legal obligations are not contractual in nature. A legal obligation having its source in an agreement only will give rise to a contract.

Example

A agrees to sell his motor bicycle to B for Rs. 5,000. The agreement gives rise to a legal obligation on the part of A to deliver the motor bicycle to B and on the part of B to pay Rs. 5,000 to A. The agreement is a contract. If A does not deliver the motor bicycle, then B can go to a court of law and file a suit against A for non-performance of the promise on the part of A.

On the other hand, if A has already given the delivery of the motor bicycle and B refuses to make the payment of price, A can go to the court of law and file a suit against B for non-performance of promise.

Similarly, agreements to do an unlawful, immoral or illegal act, for example, smuggling or murdering a person, cannot be enforceable at law. Besides, certain agreements have been specifically declared void or unenforceable under the Indian Contract Act. For instance, an agreement to bet (Wagering agreement) (S. 30), an agreement in restraint of trade (S. 27), an agreement to do an impossible act (S. 56).

An obligation which does not have its origin in an agreement does not give rise to a contract. Some of such obligations are

1. Torts or civil wrongs;
2. Quasi-contract;
3. Judgements of courts, i.e., Contracts of Records;
4. Relationship between husband and wife, trustee and beneficiary, i.e., status obligations.

These obligations are not contractual in nature, but are enforceable in a court of law. Thus, Salmond has rightly observed: “The law of Contracts is not the whole law of agreements nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations which have, their source in agreements.”

Law of Contracts creates rights in *personam* as distinguished from rights in *rem*. Rights in *rem* are generally in regard to some property as for instance to recover land in an action of ejectment. Such rights are available against the whole world. Rights in *personam* are against or in respect of a specific person and not against the world at large.

Examples

(1) A owns a plot of land. He has a right to have quiet possession and enjoyment of the same. In other words every member of the public is under obligation not to
disturb his quiet possession and enjoyment. This right of A against the whole world is known as right in *rem*.

(2) A is indebted to B for Rs. 100. It is the right of B to recover the amount from A. This right of B against A is known as right in *personam*. It may be noted that no one else (except B) has a right to recover the amount from A.

The law of contracts is concerned with rights in *personam* only and not with rights in *rem*.

◆ **ESSENTIAL ELEMENTS OF A VALID CONTRACT**

We have seen above that the two elements of a contract are: (1) an agreement; (2) legal obligation. Section 10 of the Act provides for some more elements which are essential in order to constitute a valid contract. It reads as follows:

“All agreements are contracts if they are made by free consent of parties, competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void.”

Thus, the essential elements of a valid contract can be summed up as follows

1. Agreement.
2. Intention to create legal relationship.
3. Free and genuine consent.
4. Parties competent to contract.
5. Lawful consideration.
7. Agreements not declared void or illegal.
8. Certainty of meaning.
10. Necessary Legal Formalities.

These essential elements are explained briefly.

1. **Agreement**

   As already mentioned, to constitute a contract there must be an agreement. An agreement is composed of two elements—offer and acceptance. The party making the offer is known as the offeror, the party to whom the offer is made is known as the offeree. Thus, there are essentially to be two parties to an agreement. They both must be thinking of the same thing in the same sense. In other words, there must be *consensus-ad-idem*.

   Thus, where ‘A’ who owns 2 cars *x* and *y* wishes to sell car ‘*x*’ for Rs. 30,000. ‘B’, an acquaintance of ‘A’ does not know that ‘A’ owns car ‘*x*’ also. He thinks that ‘A’ owns only car ‘*y*’ and is offering to sell the same for the stated price. He gives his acceptance to buy the same. There is no contract because the contracting parties have not agreed on the same thing at the same time, ‘A’ offering to sell his car ‘*x*’ and ‘B’ agreeing to buy car ‘*y*’. There is no *consensus-ad-idem*.

2. **Intention to create legal relationship**

   As already mentioned there should be an intention on the part of the parties to the
agreement to create a legal relationship. An agreement of a purely social or domestic nature is not a contract.

Example

A husband agreed to pay £30 to his wife every month while he was abroad. As he failed to pay the promised amount, his wife sued him for the recovery of the amount.

Held: She could not recover as it was a social agreement and the parties did not intend to create any legal relations [Balfour v. Balfour (1919) 2 K.B. 571].

However, even in the case of agreements of purely social or domestic nature, there may be intention of the parties to create legal obligations. In that case, the social agreement is intended to have legal consequences and, therefore, becomes a contract. Whether or not such an agreement is intended to have legal consequences will be determined with reference to the facts of the case. In commercial and business agreements the law will presume that the parties entering into agreement intend those agreements to have legal consequences. However, this presumption may be negatived by express terms to the contrary. Similarly, in the case of agreements of purely domestic and social nature, the presumption is that they do not give rise to legal consequences. However, this presumption is rebuttable by giving evidence to the contrary, i.e., by showing that the intention of the parties was to create legal obligations.

Examples

(1) There was an agreement between Rose Company and Crompton Company, where of the former were appointed selling agents in North America for the latter. One of the clauses included in the agreement was: “This arrangement is not... a formal or legal agreement and shall not be subject to legal jurisdiction in the law courts”.

Held that: This agreement was not a legally binding contract as the parties intended not to have legal consequences [Rose and Frank Co. v. J.R. Crompton and Bros. Ltd. (1925) A.C. 445].

(2) An agreement contained a clause that it “shall not give rise to any legal relationships, or be legally enforceable, but binding in honour only”.

Held: The agreement did not give rise to legal relations and, therefore, was not a contract. [Jones v. Vernon’s Pools Ltd. (1938) 2 All E.R. 626].

(3) An aged couple (C and his wife) held out a promise by correspondence to their niece and her husband (Mrs. and Mr. P.) that C would leave them a portion of his estate in his will, if Mrs. and Mr. P. would sell their cottage and come to live with the aged couple and to share the household and other expenses. The young couple sold their cottage and started living with the aged couple. But the two couples subsequently quarrelled and the aged couple repudiated the agreement by requiring the young couple to stay somewhere else. The young couple filed a suit against the aged couple for the breach of promise.

Held: That there was intention to create legal relations and the young couple could recover damages [Parker v. Clark (1960) 1 W.L.R. 286].

3. Free and genuine consent

The consent of the parties to the agreement must be free and genuine. The consent of the parties should not be obtained by misrepresentation, fraud, undue influence, coercion or mistake. If the consent is obtained by any of these flaws, then the contract is not valid.
4. Parties competent to contract

The parties to a contract should be competent to enter into a contract. According to Section 11, every person is competent to contract if he (i) is of the age of majority, (ii) is of sound mind, and (iii) is not disqualified from contracting by any law to which he is subject. Thus, there may be a flaw in capacity of parties to the contract. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness or status. If a party to a contract suffers from any of these flaws, the contract is unenforceable except in certain exceptional circumstances.

5. Lawful consideration

The agreement must be supported by consideration on both sides. Each party to the agreement must give or promise something and receive something or a promise in return. Consideration is the price for which the promise of the other is sought. However, this price need not be in terms of money. In case the promise is not supported by consideration, the promise will be nudum pactum (a bare promise) and is not enforceable at law.

Moreover, the consideration must be real and lawful.

6. Lawful object

The object of the agreement must be lawful and not one which the law disapproves.

7. Agreements not declared illegal or void

There are certain agreements which have been expressly declared illegal or void by the law. In such cases, even if the agreement possesses all the elements of a valid agreement, the agreement will not be enforceable at law.

8. Certainty of meaning

The meaning of the agreement must be certain or capable of being made certain otherwise the agreement will not be enforceable at law. For instance, A agrees to sell 10 metres of cloth. There is nothing whatever to show what type of cloth was intended. The agreement is not enforceable for want of certainty of meaning. If, on the other hand, the special description of the cloth is expressly stated, say Terrycot (80 : 20), the agreement would be enforceable as there is no uncertainly as to its meaning.

However, an agreement to agree is not a concluded contract [Punit Beriwala v. Suva Sanyal AIR 1998 Cal. 44].

9. Possibility of performance

The terms of the agreement should be capable of performance. An agreement to do an act impossible in itself cannot be enforced. For instance, A agrees with B to discover treasure by magic. The agreement cannot be enforced.

10. Necessary legal formalities

A contract may be oral or in writing. If, however, a particular type of contract is required by law to be in writing, it must comply with the necessary formalities as to writing, registration and attestation, if necessary. If these legal formalities are not carried out, then the contract is not enforceable at law.
Contracts may be classified in terms of their (1) validity or enforceability, (2) mode of formation, or (3) performance.

1. Classification according to validity or enforceability

Contracts may be classified according to their validity as (i) valid, (ii) voidable, (iii) void contracts or agreements, (iv) illegal, or (v) unenforceable.

A contract to constitute a valid contract must have all the essential elements discussed earlier. If one or more of these elements is/are missing, the contract is voidable, void, illegal or unenforceable.

As per Section 2 (i) a voidable contract is one which may be repudiated at the will of one of the parties, but until it is so repudiated it remains valid and binding. It is affected by a flaw (e.g., simple misrepresentation, fraud, coercion, undue influence), and the presence of anyone of these defects enables the party aggrieved to take steps to repudiate the contract. It shows that the consent of the party who has the discretion to repudiate it was not free.

Example

A, a man enfeebled by disease or age, is induced by B’s influence over him as his medical attendant to agree to pay B an unreasonable sum for his professional services. B employs undue influence. A’s consent is not free; he can take steps to set the contract aside.

An agreement which is not enforceable by either of the parties to it is void [Section 2(i)]. Such an agreement is without any legal effect *ab initio* (from the very beginning). Under the law, an agreement with a minor is void (Section 11).*

A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable [Section 2(i)].

Examples

(1) A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.

(2) A contracts to take indigo for B to a foreign port. A’s government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

* Other instances of void agreements are:
  (a) Agreements entered into through a mutual mistake of fact between the parties (Section 20).
  (b) Agreements, the object or consideration of which is unlawful (Section 23).
  (c) Agreements, part of the consideration or object of which is unlawful (Section 21).
  (d) Agreements made without consideration (Section 25).
  (e) Agreements in restraint of marriage (Section 26).
  (f) Agreements in restraint or trade (Section 27).
  (g) Agreements in restraint of legal proceedings (Section 28).
  (h) Uncertain agreements (Section 29).
  (i) Wagering agreements (Section 30).
  (j) Impossible agreements (Section 56).
  (k) An agreement to enter into an agreement in the future.
In the above two examples, the contracts were valid at the time of formation. They became void afterwards. In example (1) the contract became void by subsequent impossibility. In example (2) the contract became void by subsequent illegality.*

It is misnomer to use ‘a void contract’ as originally entered into. In fact, in that case there is no contract at all. It may be called a void agreement. However, a contract originally valid may become void later.

An illegal agreement is one the consideration or object of which (1) is forbidden by law; or (2) defeats the provisions of any law; or (3) is fraudulent; or (4) involves or implies injury to the person or property of another; or (5) the court regards it as immoral, or opposed to public policy.

Examples

(1) A, B and C enter into an agreement for the division among them of gains acquired or to be acquired, by them by fraud. The agreement is illegal.

(2) A promises to obtain for B an employment in the public service, and B promises to pay Rs. 1,000 to A. The agreement is illegal.

Every agreement of which the object or consideration is unlawful is not only void as between immediate parties but also taints the collateral transactions with illegality. In Bombay, the wagering agreements have been declared unlawful by statute.

Example

A bets with B in Bombay and loses; makes a request to C for a loan, who pays B in settlement of A’s losses. C cannot recover from A because this is money paid “under” or “in respect of a wagering transaction which is illegal in Bombay.

An unenforceable contract is neither void nor voidable, but it cannot be enforced in the court because it lacks some item of evidence such as writing, registration or stamping. For instance, an agreement which is required to be stamped will be unenforceable if the same is not stamped at all or is under-stamped. In such a case, if the stamp is required merely for revenue purposes, as in the case of a receipt for payment of cash, the required stamp may be affixed on payment of penalty and the defect is then cured and the contract becomes enforceable. If, however, the technical defect cannot be cured the contract remains unenforceable, e.g., in the case of an unstamped bill of exchange or promissory note.

Contracts which must be in writing. The following must be in writing, a requirement laid down by statute in each case:

(a) A negotiable instrument, such as a bill of exchange, cheque, promissory note (The Negotiable Instruments Act, 1881).

(b) A Memorandum and Articles of Association of a company, an application for shares in a company; an application for transfer of shares in a company (The Companies Act, 1956).

(c) A promise to pay a time-barred debt (Section 25 of the Indian Contract Act, 1872).

* Other examples of contracts becoming void are:

(a) A contingent contract to do or not to do anything if an uncertain future event happens becomes void if the event becomes impossible (Section 32).

(b) A contract voidable at the option of the promisee, becomes void when the promisee exercises his option by avoiding the contract. (Sections 19; 19A).
(d) A lease, gift, sale or mortgage of immovable property (The Transfer of Property Act, 1882).

Some of the contracts and documents evidencing contracts are, in addition to be in writing, required to be registered also. These are:

1. Documents coming within the purview of Section 17 of the Registration Act, 1908.
2. Transfer of immovable property under the Transfer of Property Act, 1882.
3. Contracts without consideration but made on account of natural love and affection between parties standing in a near relation to each other (Section 25, The Indian Contract Act, 1872).

2. Classification according to mode of formation

There are different modes of formation of a contract. The terms of a contract may be stated in words (written or spoken). This is an express contract. Also the terms of a contract may be inferred from the conduct of the parties or from the circumstances of the case. This is an implied contract (Section 9).

Example

If A enters into a bus for going to his destination and takes a seat, the law will imply a contract from the very nature of the circumstances, and the commuter will be obliged to pay for the journey.

We have seen that the essence of a valid contract is that it is based on agreement of the parties. Sometimes, however, obligations are created by law (regardless of agreement) whereby an obligation is imposed on a party and an action is allowed to be brought by another party. These obligations are known as quasi-contracts. The Indian Contract Act, 1872 (Chapter V Sections 68–72) describes them as “certain relations resembling those created by contract”.

Examples

(1) A supplies B, a minor, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B’s property.

(2) A supplies the wife and children of B, a minor, with necessaries suitable to their condition in life. A is entitled to be reimbursed from B’s property.

(3) A, a tradesman, leaves goods at B’s house by mistake. B treats the goods as his own. B is bound to pay A for them.

In all the above cases, the law implies a contract and a person who has got benefit is under an obligation to reimburse the other.

3. Classification according to performance

Another method of classifying contracts is in terms of the extent to which they have been performed. Accordingly, contracts are: (1) executed, and (2) executory or (1) unilateral, and (2) bilateral.

An executed contract is one wholly performed. Nothing remains to be done in terms of the contract.

Example

A contracts to buy a bicycle from B for cash. A pays cash. B delivers the bicycle.
An executory contract is one which is wholly unperformed, or in which there remains something further to be done.

*Example*

On June 1, A agrees to buy a bicycle from B. The contract is to be performed on June 15.

The executory contract becomes an executed one when completely performed. *For instance*, in the above example, if both A and B perform their obligations on June 15, the contract becomes executed. However, if in terms of the contract performance of promise by one party is to precede performance by another party then the contract is still executory, though it has been performed by one party.

*Example*

On June 1, A agrees to buy a bicycle from B. B has to deliver the bicycle on June 15 and A has to pay price on July 1. B delivers the bicycle on June 15. The contract is executory as something remains to be done in terms of the contract.

A *Unilateral Contract* is one wherein at the time the contract is concluded there is an obligation to perform on the part of one party only.

*Example*

A makes payment for bus fare for his journey from Bombay to Pune. He has performed his promise. It is now for the transport company to perform the promise.

A *Bilateral Contract* is one wherein there is an obligation on the part of both to do or to refrain from doing a particular thing. In this sense, Bilateral contracts are similar to executory contracts.

An important corollary can be deduced from the distinction between Executed and Executory Contracts and between Unilateral and Bilateral contracts. It is that a contract is a contract from the time it is made and not from the time its performance is due. The performance of the contract can be made at the time when the contract is made or it can be postponed also. See examples above under Executory Contract.

### Classification/Types of Contracts

1. **From the point of view of enforceability**
   - (a) Valid contracts
   - (b) Voidable contracts
   - (c) Void contracts or agreements
   - (d) Illegal agreements
   - (e) Unenforceable Agreements (Certain contracts must be in writing)

2. **According to Mode of Formation**
   - (a) Express contract
   - (b) Implied contract
   - (c) Quasi-contracts

3. **According to Performance**
   - (a) Executed
   - (b) Executory
   - (c) Uni-lateral
   - (d) Bi-lateral