



CHAPTER

3(A)

Law of Contracts

Learning Outcome

Students will be able to

- Understand the formation of agreements and contracts.
- Understand the essential elements of a contract.
- Distinguish between the types of contracts based on enforceability
- Understand and analyse illegal, void and voidable agreements.
- Elaborate the process of discharge of contract.
- Critically analyse the remedies awarded for Breach of Contract as Damages.

Amritlal was in need of 5 kg rice and exchanged them for 10 kg mangoes with his next-door neighbour to avoid going to the market. He soon realised that he has given a rare commodity, as it was not the mango season, at a cheap exchange. It has been a common practice to exchange things of utility in the ancient times. However, with the advent of money as a common medium of exchange that is fair and uniformly valued at a given place, it has become easy to enter into transactions that are definite. In the modern times, these definite transactions are known as 'contract'. The contracts regulate the business transactions among parties placed both domestically and internationally.

A. Introduction to Contracts

Contracts are an important part of commercial law because all commercial law transactions usually begin with an agreement or a contract. To understand the concept, we may take example of some of our everyday activities like buying groceries, booking a cab, eating at a restaurant, paying for internet, purchasing clothes in a sale or otherwise and likewise.

These business transactions involving sale-purchase or exchange of services have become an integral part in day-to-day activities that involve contracts. In such instances, an agreement or a contract is necessary for determining the rights, obligations and liabilities of parties when they enter into any business transaction. The Indian Contract Act is the law governing contracts in India.

B. Formation of Contract

According to the Indian Contract Act, 1872, (referred to as the ICA) an agreement that is enforceable by law is a contract [Section 2(h)]. This implies, all agreements *per se* are not contracts. Agreements must meet certain criteria stated as under- An agreement is the result of a proposal or an offer by one party and its acceptance by the other.

1. **Competent parties:** the parties to the agreement must be competent to enter into a contract.
2. **Lawful consideration and lawful object:** There must be lawful object and lawful consideration in respect of the agreement.
3. **Free consent:** there must be free consent of the parties that is free from coercion, undue



influence, fraud, misrepresentation and mistake, when they enter into the agreement.

4. **Not expressly declared as void by the law:** the agreement must not be the one, which has been declared as void by the law in force at the time of entering into the agreement.

It is therefore true by virtue of provisions of section 10 ICA that all contracts are enforceable agreements while the vice-versa may not be true when an agreement is not enforceable by law for want of lawful consideration or lawful object. Thus it is correct to generalise that:

“All contracts are agreements but all agreements are not contracts”

C. Intention to Contract

In a leading case *Balfour v. Balfour* (1919, 5 KB 571), the validity of an agreement entered between a husband and wife was in question. The husband and wife went on leave to England and the wife fell ill in England. The doctors who treated the wife advised her to take full bed rest and remain in England in order to continue the treatment. The wife stayed in England. When the leave was over, the husband went to Ceylone where he was employed and promised to send a sum of £30 to the wife every month for her stay in England. He sent the amount for some time and later on due to differences and misunderstanding between them, the husband stopped sending the amount. The wife initiated action to recover the arrears due to her. The Court dismissed it on the ground that the agreement entered into between the husband and wife was not a contract. The arrangement between the husband and wife was only a moral obligation and the parties never intended to create any legal relationship.

The decision clearly shows that agreements that create a legal obligation are only contracts and those agreements that do not intend to create legal relationship are not contracts.

Offer / Proposal and Acceptance

The offer or proposal is the first step in the formation of a contract. When one person signifies to another his willingness to do or not to do certain things, it is called an Offer. [Section 2(a) of ICA]. The person making the proposal or offer is called the offeror and the person to whom the offer is made is called the offeree. The offer given must be with an intention to create a legal relationship.

An assent or consent given to an offer by the offeree is known as Acceptance [Section 2(b) of ICA]. By saying ‘yes’, ‘ok’ or clicking on ‘I agree’ on an offer on a website also amounts to acceptance. An offer when accepted becomes an agreement. An agreement is also called as promise.

Offer + Acceptance = Agreement

Illustration

A expresses his willingness to sell his cottage to B for Rs. 5 lakhs. Here, A's willingness is called offer. A is the offeror and B is the offeree. B accepts the offer to purchase the cottage. This is called Acceptance. A's offer when accepted by B becomes an Agreement.

An offer and acceptance must be definite and certain. If the offer or acceptance is not clear enough to conclude a contract, it is considered invalid. Also, an offer and acceptance must be communicated to the other person in order to be valid. A communication in electronic form or over emails also amount to communication of offer and acceptance. An offer lapses by revocation or withdrawal. Any offer can be revoked before acceptance.

General offer

In an English case *Carlill v. Carbolic Smoke Ball Co.* (1893, 1 QB 256), the company was the manufacturer of a medicine called smoke ball which was used for the treatment of influenza. The company believed that the medicine completely cured influenza. An advertisement was put up



offering a reward of £100 to anyone who got influenza again after using the smoke ball medicine continuously for fifteen days. In the advertisement, it was also stated that £1000 was deposited in a Bank, namely, Alliance Bank for paying the reward if such situation arose. Seeing the advertisement, Mrs. Carlill bought the smoke ball medicine and used it as per the directions provided. Mrs. Carlill got a fresh episode of influenza. Mrs. Carlill sued the company for the reward of £100. The manufacturing company stated that: (1) there was no intention to enter into a legal relationship with anyone through the advertisement, and the advertisement was put up only to boost the marketing of the smoke ball medicine; (2) the advertisement was not an offer as it was not made to any particular person and an offer cannot be made to the public at large or to the whole world; (3) acceptance by the offeree had not been communicated, and so there was no binding contract. The Court rejected these contentions of the company and allowed Mrs. Carlill's claim for £100. The Court also stated that deposit of £1000 in the Alliance Bank by the Smoke Ball Company was evidence that the company had real intention to enter into a legal relationship with anyone who accepted the offer. An offer can also be made to the world at large. It is called a general offer and it is valid. In the case of general offer, there is no need for communicating acceptance to the offeror. Merely fulfilling the conditions of the offer itself is treated as acceptance to create a contract.

D. Consideration

Consideration is an important element in a contract. A contract without consideration is not valid. Consideration means 'something in return' for the offer. Consideration can be in the nature of an act or forbearance. The general rule is that, an agreement without consideration is void and not enforceable by law because in such cases, one party is getting something from the other without giving anything to the other. There should always be a mutual consideration. In other words, each party must give and also take. There are exceptions to this general rule in certain situations such as a written and registered agreement out of natural love is not void, even if it is without consideration. Consideration need not be adequate, but should be real. It may be past, present or future and should not be illegal, immoral or opposed to public policy.

Illustration:

A offers to sell his car for ₹ 50,000/- to B. B accepts the offer. In this case, the consideration of A is his car and the consideration of B is ₹ 50,000/-.

Illustration:

A, for natural love and affection, promises to give his son, B, ₹ 1,000/- to Bin writing and registers it. This is a contract and absence of consideration does not make it void.

In an Indian case - *Durga Prasad V. Baldeo* (1880, 3All 221), the plaintiff constructed some shops at the request of the District Collector in a town. The constructed shops were given on rent for doing business to the defendant, the shopkeeper. The defendant, apart from the rent, promised to give 5% commission to the plaintiff on all articles sold through the shop in consideration of the huge amount spent by the plaintiff in the construction of the building. The defendant failed to pay the commission and the plaintiff initiated action to recover the commission. The Court rejected the action of the plaintiff on the ground that the construction of shop was done at the desire of the District Collector and not on the desire of the defendant and hence there was no consideration to give commission. Accordingly, there is no valid contract to pay commission to the plaintiff.

E. Capacity to Contract

One of the essentials of a valid contract as mentioned under section 10 ICA is that the parties must be competent to contract. Following are not competent to contract :

- Minor - Persons who are less than 18 years of age;
- Persons with unsound mind
- Persons disqualified by law - Alien enemies, Foreign sovereign etc.



Who is a minor under Indian Law?

It was the Indian Majority Act that laid down the age of majority as 18 years except in cases where guardian has been appointed by the Court, it was 21 years. An amendment to the said Act has amended the majority age to 18 years for all cases.

Illustration:

A (major) offers to sell his coat for ₹ 3,000/- to B (minor). B accepts the offer and pays ₹ 3,000/-. A states that the contract is entered into with a minor and hence void. In this case, even if the contract is entered into with a minor, it is enforceable because it is beneficial to the minor and the minor has performed his part of the obligation in the contract.

Interesting Facts

A minor is incompetent to contract because he is below 18 years of age. Indian Contract Act does not answer whether an agreement by a minor is void or voidable? Nature of minor's agreement has been analyzed by the courts from time to time based on the facts and circumstances of the case in light of general principles of equity and natural justice. Initially, the controversy was set at rest by the decision of Privy Council in **Mohori Bibee v Dharmodas Ghose**. The minor Plaintiff mortgaged his property in favour of the defendant who was a money lender, to secure his loan. The money lender had knowledge about the minority of the Plaintiff. The court held against the contentions of the defendant that no estoppel could apply against the Plaintiff as both the parties were aware of the minor's minority. Also, the defendant asked for the refund of loan taken under the provisions of ICA if mortgage is cancelled. Court held that an agreement by a minor is *void ab initio*.

In another case, **Kalus Mittelbachert v East India Hotels Ltd.**, there was a contract between Lufthansa, a German airline and Hotel Oberoi, New Delhi that crew of the airline will stay in latter's hotel. The plaintiff, a co-pilot of the airline stayed in the hotel and sustained serious head injuries on diving in the swimming pool of the hotel. This resulted in paralysis and after a battle of 13 years with his health conditions he died. Though he had no direct contract with hotel but he succeeded as a beneficiary and was awarded compensation for the damage caused. Being a 5-star hotel extra care and caution was expected out of the hotel and thus exemplary damages of 50 lac were awarded.

F. Consent

Consent is an important criterion while entering into a contract. When two persons agree on the same thing in the same sense (*consensus ad idem*), it is termed as consent (Section 13). Consent should be free and not caused by coercion, undue influence, misrepresentation, fraud or mistake. If consent is obtained by the influence of any one of the above said, then the consent so obtained is not free. It becomes voidable (avoid enforcement of contract) for the person whose consent is not free.

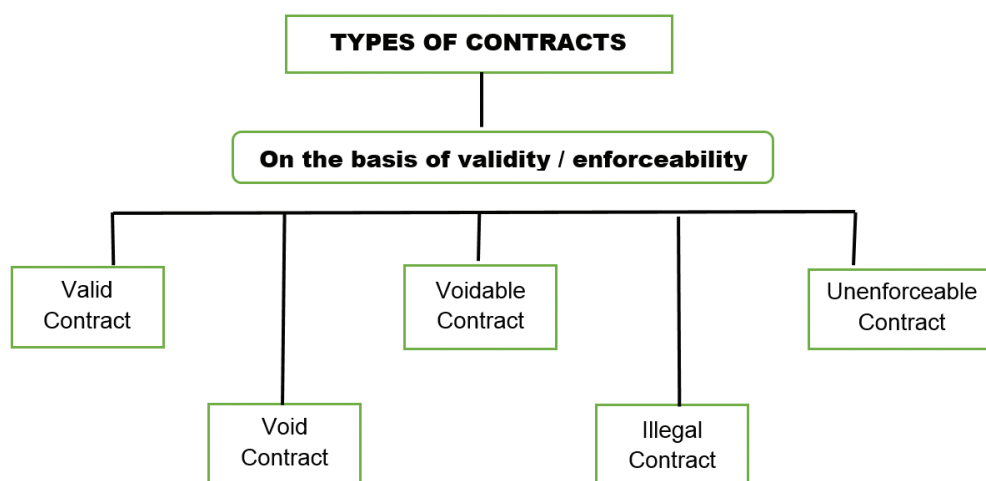
Illustration:

A threatened to kill B if he does not sell his house to A. B out of fear signs the contract for selling his house to A. Here, the consent of B is not free. B can later avoid the sale on the ground that he was compelled to agree to the sale and the consent given was not free consent.

G. Types of Contracts/ Agreements

As discussed above, all agreements may not be contracts and vice versa. There are situations when agreements turn into contracts at their inception but at a later stage due to change in any of the essential conditions of a contract, a contract ceases to be enforceable under the law and thus becomes void at the option of any of the parties to the contract. Also, when the consent obtained for the agreement is not free, it is voidable.

The concept of validity or enforceability of a contract is not defined in Indian Contract Act however, it



is through the various judgements of the courts that enforceability of contracts was decided based on their validity. Some important valid and enforceable contracts are explained as under:

a. Void and Voidable Contracts

BASIS OF DIFFERENCE	VOID CONTRACT	VOIDABLE CONTRACT
LEGAL PROVISION	Section 2(j) ICA	Section 2(i) ICA
MEANING	A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable	It is a contract which may either be affirmed or rejected at the option of one of the parties to the contract on ground of coercion, undue influence, fraud or misrepresentation.
NATURE	It is valid at its inception but later culminates into a void contract	It remains enforceable till it is not declared void by a competent court
CLAIM FOR DAMAGES	It is allowed only to the extent to restore any benefit received by the party, on the grounds of equity	The injured has the right to initiate action for damages
VALIDITY	Any contract when turns void, cannot thereafter become valid	A voidable contract may become valid upon lapse of time, affirmation, ratification, waiver of right, acquiescence of the party whose consent was not free

**b. Contingent and Wagering**

BASIS OF DIFFERENCE	CONTINGENT CONTRACTS	WAGERING AGREEMENTS
LEGAL PROVISION	Contingent contract is defined under section 31 of ICA.	ICA does not define wagering agreements.
MEANING	A contingent contract is a contract to do or not to do something depending upon the happening or non-happening of a future uncertain event.	Section 30 ICA does not define wagering agreements but declares them to be void. The parties have opposite views regarding an uncertain event and equal chances of gain or loss. There is no other interest of the parties in the agreement except for winning or losing it.
ENFORCEABILITY	A contingent contract is enforceable under the law	A wagering agreement is not enforceable under the law
UNCERTAIN FUTURE EVENT	The uncertain future event does not determine the outcome of the contract. It is only collateral to the contract.	The uncertain future event decides who wins the wager.
RECIPROCAL PROMISE	There may or may not be reciprocal promise.	It is a bet and is thus based on reciprocal promise.
EXAMPLE	For example, A promises to buy B the Indian cricket team's jersey, if they win the match today. Now, this is a contingency as there's no guarantee whether India will win the match. In the same example, A promises to buy B the jersey if he pays him the money, then this will be a promissory condition that depends on the performance of a duty.	For example, X enters into a wager with Y. If X's food tech start-up gains at least 50,000 customers in 6 months, then Y shall pay X a certain monetary sum, and if it doesn't hit the target, then X shall pay Y the same amount.

c. Illegal / Unlawful Agreements

According to section 10 ICA, a contract must be made for a lawful consideration and lawful object. If either the consideration or the object is an action or omission prohibited by law, it results into an illegal contract. The agreements entered into for any unlawful or illegal object or consideration cannot be enforced under the law and are thus void (sec. 24 ICA). However, there is a possibility that the object or the consideration with which the contract was formed initially later turns unlawful or illegal, in which case it becomes void.

Illustration:

A enters into an agreement with B to share the profits by giving false assurance to the public to get them a job in Singapore. The agreement involves cheating which is a fraudulent act. The agreement is unlawful and hence it is void.



Illustration:

A agrees to give Rs 1,000/- to B as penalty if minor daughter is not given to A in marriage. This agreement is opposed to public policy and not enforceable.

H. Discharge of Contract

Mutual obligations of parties are created in a contract. When the mutual obligations of the parties are fulfilled, the contract comes to an end. When the contract is ended, it is said to be discharged. In other words, Discharge means termination of the contractual relations of the parties to the contract.

Discharge of a contract may be done by the following ways:

- 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.

a. Discharge by Performance

When parties to a contract perform their obligations and fulfil their promises, the contract gets discharged by performance.

Illustration:

An offer to sell his dining set to B for Rs 10,000/-. B pays Rs. 10,000/- to A and A delivers his dining set to B. Here the contract gets discharged by performance as both the parties fulfilled their promises.

b. Discharge by Agreement or Consent

When parties to the contract do not perform their obligations and fulfil their promises in full or in part, as the case may be, the contract gets discharged by novation, rescission, alteration, merger, waiver and remission.

- (i) **Novation** - A new contract is substituted for an old contract.

Illustration:

A is indebted to B and B to C. By mutual agreement B's debt to C and A's debt to B is cancelled and C accepts A as his debtor. This is new contract substituting the old one and hence, novation.

- (ii) **Rescission** - Certain terms or all terms of a contract are cancelled.

Illustration:

A enters into an agreement with B for buying certain machine parts for their project. Before the agreement ends, A and B change certain terms of the agreement and include those terms in the agreement.

- (iii) **Remission** - Acceptance is made to a promise but not on the complete terms

Illustration:

A owes B Rs 5,000/-. A pays to B and B accepts Rs 2,000/- in full satisfaction to the whole debt. The old debt is discharged but to a lesser fulfilment of the promise.

- (iv) **Merger** - Certain terms of a contract or all the terms of a contract are merged into another contract with the consent of the parties.

**Illustration:**

A enters into a contract with B for the supply of 50 bags of wheat on a specified date. Later it was realised by A that he needs 10 bags of mixed pulses also at the same time. A and B merge the two contracts to supply 50 bags of wheat and 10 bags of mixed pulses on the same date and at the same place.

(c) Discharge by Impossibility of Performance

Performance of a contract can become impossible with or without the knowledge of the parties to the contract. A contract may later become unenforceable under the law due to impossibility of performance.

It can become impossible to perform the contract subsequently after the parties have entered into the contract, this is known as supervening impossibility [Section 56 ICA]. Supervening impossibility takes place by the following:

- Destruction of the subject matter;
- Death or incapacity;
- Non-existence of state of things having an effect directly or indirectly on the contract;
- Outbreak of war;
- Change or amendments in law.

Illustration:

X agreed to sell his car to Y for Rs. 1 lakh and deliver it after two months. After a week, X met with an accident and car got completely destroyed. The contract gets discharged by impossibility of performance as the car was completely destroyed.

(d) Discharge by Lapse of Time

Time is very significant while entering into a contract. If the contract is not performed within the specified time and the other party does not resort to any action within the limitation period, then he is deprived of his remedy and the contract gets discharged by lapse of time.

(e) Discharge by Operation of Law

The following are instances where a contract gets discharged by operation of law:

- Death of either of the parties;
- Insolvency;
- Merger;
- Unauthorized alteration of the terms of the agreement.

(f) Discharge by Breach of Contract

Breach means failure to perform the obligation by a party. When a party to a contract does not perform his part of the obligation due to which the contract becomes broken, the person who suffers because of the breach is entitled to receive compensation or damages from the party who has breached the contract (Section 73).

Illustration:

A agrees to supply 20 litres of oil to B on 1st June 2014. On 1st June 2014, A does not supply the oil. Then A has breached the contract. Suppose A has supplied the oil but B does not accept the oil, then B has breached the contract. In the first instance, B is entitled to receive compensation from A. In the latter instance, A is entitled to receive compensation from B.



I. REMEDIES IN CASE OF BREACH

A remedy implies a relief given by law to ensure the enforcement of contractual rights or to provide sufficient compensation for the non-performance. In the matters of breach of contract, the remedies available are:

- Damages
- Specific performance

Damages are the most common remedy available to the injured party. It entitles them to recover the money compensation for the losses suffered due to the breach. In India it is covered in section 73 ICA.

The purpose of a contract is to enforce the rights of parties, in event of breach the promisee can request the performance of specific obligations.

Illustration:

A agrees to deliver 40 bags of rice to B for Rs. 20,000/- on 15th July 2022. On 15th July 2022, A delivers only 20 bags of rice to B. B is entitled for damages from A for the loss that he suffered because of A (non-delivery of 20 bags of rice).

Illustration:

A contracts to repair B's house in a certain manner, and receives payment in advance. A repairs the house but not according to the contract. B is entitled to recover from A the cost of making the repairs conform to the contract.

Exercise

Based on your understanding, answer the following questions:

1. Ramesh sells his bike to his friend Suresh for a consideration of Rs. 50,000/-, whereas the market price of the said bike is Rs. 65,000/-. Examine if the agreement is enforceable under Law of Contract.
2. 'D', a minor borrowed a sum of money from M by executing a mortgage of his property in favour of M. Subsequently, D sued for cancellation of mortgage. Is the contract of mortgage valid? Can M recover the sum advanced to D?
3. Apexx Chemicals entered into an agreement with Moonled Pharma Ltd. to supply them with 16 units calcium and 8 units of magnesium powder for its medicine unit. By the time Apexx Chemicals supplied 12 units of calcium and 4 units of magnesium the government restricted free sale of chemicals for life saving drugs. Every dealer was supposed to get his supply sanctioned from the government to a maximum of 10 units of each chemical. Apexx chemicals found it difficult to complete the order of Moonled Pharma Ltd., Moonled Pharma Ltd. brings a suit for breach of contract against Adarsh Chemicals. Will it succeed? Analyze by referring to relevant provisions.
4. X enters into a contract with Y to pay him 10000 rupees if the books are delivered to him by Friday. This is an example of contingent contract. Explain why?

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