

**UNIT – I**  
**LAW OF CONTRACT – 1872**

**Definition of Business**

The term business is understood and explained in different ways by different people. For some, business is an activity, for some it is a method of transacting, for some others, it is a method of money making and some people argue that business is an organized activity to achieve certain pre- determined goals or objectives. Dictionary meaning of business is: the act of buying and selling of goods and services, commerce and trade. Based on all these meanings of business, we may define business as: gainful activity through which various elements of society conduct exchanges of the desirable things.

**Nature of Business**

Business may be understood as the organized efforts of enterprise to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume. But, all businesses share the same purpose to earn profits.

The purpose of business goes beyond earning profit. There are:

- ✓ It is an important institution in society.
- ✓ Be it for the supply of goods and services
- ✓ Creation of job opportunities
- ✓ Offer of better quality of life
- ✓ Contributing to the economic growth of the country.

Hence, it is understood that the role of business is crucial. Society cannot do without business. It needs no emphasis that business needs society as much.

**Business Goals:**

**Profit** - Making profit is the primary goal of any business enterprise.

**Growth** - Business should grow in all directions over a period of time.

**Power** - Business houses have vast resources at its command. These resources confer enormous economic and political power

**Employee satisfaction and development** - Business is people. Caring for employee satisfaction and providing for their development has been one of the objectives of enlightened business enterprises.

**Quality products and services** - Persistent quality of products earns brand loyalty, a vital ingredient of success.

**Market leadership** - To earn a niche for oneself in the market, innovation is the key factor.

**Challenging** - Business offers vast scope and poses formidable challenges.

**Joy of creation** - It is through business strategies new ideas and innovations are given a shape and are converted into useful products and services.

**Service to society** - Business is a part of society and has several obligations towards it.

**Objectives:**

The primary aim of this unit is to enable you to:

- ✓ Understand the role of Government in regulating the economic and business activities;
- ✓ Have adequate insights into the concept of law of contract and its various essential elements;
- ✓ Explain the performance, discharge and remedies of breach of contract;
- ✓ Know the principles of Partnership and Sale of Goods and their related provisions;
- ✓ Describe the legal provisions relating to Law of Insurance and Negotiable Instruments

Most of the business transactions are based on promises to be performed at a later date. These promises whether made by businessmen or by others create certain rights and obligations and if these rights and obligations are not enforceable, the business world would be paralyzed. It is with the enforcement of these promises that the law of contract is concerned. The contract Act does not lay down the list of obligations that would be enforceable by law but lays down the rules subject to which rights or duties created by the parties would be enforced. The parties to the contract can make whatever rules they want, if these rules are not inconsistent with the provisions of the Act, they would be enforced by courts of law.

**Meaning:** Sec.2 (h) “An agreement enforceable by law is a contract.” Therefore, a contract has two important elements, one is the agreement, and the other is the obligation which is enforceable by law.

**Agreement:** Agreement is the outcome of the consensus between the parties who enter into a contract, i.e., the promise made between them, represents concurrence of their minds. (Sec.13). these would not be an agreement if the parties do agree but not on the same thing in the same sense, i.e., consensus is not sufficient. There has to be **consensus ad idem**. Sec.2 (e) defines an agreement as “Every promise or every set of promises forming consideration for each other”. A proposal when accepted becomes a promise.

**Example:** A received Rs.10, 000 from B and promises to supply him 10 bags of rice after 10 days. It is a promise. It shall be a set of promises if A promises to supply 10 bags of rice after 10 days and B promises to pay him Rs.10, 000 after the rice is supplied. Thus,

Agreement = Offer + Acceptance.

**Offer (Proposal):** Offer [(proposal) (Sec.2 (a))] “When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal”.

**Acceptance:** Acceptance has been defined u/s (Sec.2 (b)) as “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”.

**Example:** A lost his Cell Phone and announced that anybody who brought his cell phone back home would receive Rs.500 as reward. B heard the announcement and brought the Cell Phone back home. He is said to have accepted the proposal by doing the act required by A and hence he can recover the reward.

**Promissory:** A person who makes the promise is called the „**Promissory**“ or „**Offer or**“. And the person to whom the proposal is made is known as „**Promise**“ or „**Offeree**.“ In case an agreement is a set of promises, then a person becomes a **promissory** and **promise**. Thus if there is an offer, acceptance and consensus ad idem between the parties, there is an agreement. However, this agreement does not become a contract unless there is a corresponding obligation, i.e., enforceability at law.

**Obligation (Sec.10):** It is the legal duty of a person to carry out what he has promised to do or not to do. All agreements are contracts if they are made by the free consent of the parties competent to enter into contract, for a lawful consideration and with a lawful object and not hereby expressly declared to be void. Therefore, a person becomes legally bound to do what he has promised to do only if the following conditions are fulfilled.

#### **Essential elements of Contract:**

**Capacity of the Parties:** Only those persons who are competent to enter into a contract can create valid obligations. A minor, a lunatic, a drunkard etc., suffer from flaw in capacity to Contract and therefore the contract made with them can't be enforced against them.

**Free Consent:** Absence of consent does not create a legal obligation. For an agreement to become a contract the parties to an agreement should give their consent

to the agreement out of their own free will. It should not be induced by coercion, undue influence, fraud, misrepresentation, etc.

**Lawful Consideration and Object:** Consideration means something in return, i.e., „quid pro quo.“ E.g. A promises to give his bike to B for no money, here, there is no consideration, hence no obligation. Without consideration a promise can't be enforceable by law. However, consideration need not be in money or in kind. It may be of an act, abstinence, a promise to do, or not to do something. But consideration should be lawful.

Example: A promises to pay a sum of money to B if B smuggles the object proposed by A. In this case, there is no lawful object.

1. **Intention to create Legal Relationship:** Social obligation can't bring legal relationship. For example: Father promised his son to pay Rs.100 per day for pocket expenses, however, later on, did not pay the said amount. Therefore, if the parties do not intend to be bound by law at the time they make promises, nothing can bind them to their promises, later on.
2. **Possibility of Performance:** Example: A promised B that he would make The Sun rises in the West if B pays him Rs.1 lakh. And B agreed to it, this agreement does not create any legal obligation as it would not be enforceable by law.
3. **Meaning should be certain:** Example: A agrees to sell B's horse. There is nothing whatever to show which horse is intended. The agreement is void for uncertainty.
4. **Legal Formalities (If required):** An agreement to make a gift for natural love and affection should not only be in writing but registered also (Sec. 25). In the absence of any such specific requirement an oral agreement is as enforceable as a written agreement.
5. **Agreements not declared Void:** Indian Contract Act has specifically declared some agreements to be not enforceable at law e.g. Agreements in restraint of trade, Agreements in restraint of marriage, wagering agreements etc. Thus the law of Contract is not the whole law of Agreements. It is the law of those agreements which create obligations.

### **Kinds of Contracts**

1. **Valid Contract:** It is an agreement which fulfils all the essentials of enforceability and can be enforced by either of the parties at the courts of law.

2. **Voidable contract:** Sec 2(I) lays down that “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.” This arises where the consent of one of the parties to the contract is not free. Ex., A, at the point of pistol makes B agree to sell his bicycle for Rs.500. Here B’s consent is not free.

Circumstances in which a contract is voidable are:

(A) At the conception

1. Consent caused by fraud (Sec.14, 17 and 19)
2. Consent caused by coercion (Sec. 14, 15 and 19)
3. Consent caused by misrepresentation (Sec. 14, 18 and 19)
4. Consent caused by undue influence (Sec. 14, 16 and 19A)
5. When one party induces another to enter into an agreement the object of which is unlawful though it is not known to the other party.

(B) By Subsequent Default

1. Where offer of performance is not accepted (Sec. 38)
2. When one party prevents performance of reciprocal promise (Sec. 53)
3. When a party fails to perform at the time fixed, if time is the essence of the contract (Sec.55) Consequences of Rescission of Voidable Contract when a voidable contract is rescinded?
  - A. As regards the party at whose option the contract is voidable, if he has received any benefit from another party to such contract, he must restore such benefit so far as may be, to the person from whom it has been received. The benefit must have been received under the contract and not otherwise. Security for performance is not the benefit received under the contract.
  - B. As regards the other party, he need not perform his promise.
3. **Void Contract:** [Sec 2(j)] “A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable” E.g. A agrees to sell his car to B for Rs.10, 000. All essentials of a contract are fulfilled. If A refuses to sell his car, B can go to the court

and the court would enforce A's promise. But if, before the delivery the car is destroyed by Tsunami, the court cannot enforce anything and hence this contract becomes unenforceable i.e. void. Thus, void contract is one which was a valid contract when it was made but becomes void later on.

Those Agreements which are *void abs initio* (from the very beginning) are called Void Agreements and those which become void later on are called Void Contracts.

Following circumstances will transform a valid contract into a void contract.

- A. **Contingent contract:** A contingent contract to do or not to do something on the happening of an uncertain future event becomes void, when the event becomes impossible (Sec 32).
- B. **Repudiation of a voidable contract:** When a voidable contract is rescinded by the party at whose option it is voidable, the contract becomes void.
- C. **Subsequent impossibility (Sec. 56):** A contract which becomes impossible to perform, after it is made, becomes void.
- D. **Subsequent illegality (Sec. 56):** A contract becomes void if it becomes illegal after it is made.

Consequences of a Void Contract: Sec. 65 lays down that when a contract becomes void, the party who has received any advantage under such agreement should restore it or make compensation for it to the party from whom he received it.

4. **Void Agreement:** An agreement not enforceable by law is called a void agreement. If any of the essentials of obligations (enforceability), other than free consent, is missing the agreement cannot be enforced at Courts of Law.

### **Invalidating Causes**

In the following circumstances an agreement is void abs initio.

- i. If a party to the contract is incompetent to contract (Sec.10, 11 & 12)
- ii. If the agreement is without consideration (Sec. 10, 25) barring certain exceptions.
- iii. If the consideration or object is unlawful (Sec. 23)
- iv. If the meaning of the contract is uncertain (Sec.29)
- v. If the agreement is to do an impossible act (Sec. 56)
- vi. If both the parties enter into an agreement under a mistake as to the essential matter of fact (Sec. 20). There is no consensus ad idem.

Vii If the agreement is in restraint of trade (Sec. 27) barring certain exceptions.

5. **Illegal Agreement:** An illegal agreement is one which is forbidden by law i.e. it is entered into with the intention of violating the law. Example: A agrees to steal furniture for B for a consideration of Rs. 1, 00,000. It is illegal and therefore it is void. It also attracts the penal provisions of the law it is violating.  
While all illegal agreements are void, all void agreements are not illegal. Parties to an illegal agreement cannot get any help or protection from law courts.
6. **Unlawful Agreements:** (Sec. 23). In simple words an agreement may be unlawful because it is:
  - a. **Immoral** – i.e. contrary to sound and positive morality as recognized by law, e.g. cohabitation.
  - b. **Opposed Public Policy** – i.e. contrary to the welfare of the State as tending to interfere with the civil or judicial administration, or with individual liberty of citizens, e.g. bribing a public servant.
  - c. **Illegal** – i.e. contrary to positive law, being forbidden either by statutes law or common law; hence a line of demarcation needs to be drawn between illegal and unlawful agreements.
7. **Unenforceable Contract:** Contracts which have all the essentials of enforceability but cannot be enforced due to certain technicalities like insufficiency of stamp, etc. are termed as unenforceable contracts.
8. **Express Contract:** It is one where the intention of parties is stated in words either



written or spoken. Example: A goes to B's shop and asks him to supply 10 boxes @ Rs.20 per box. B tells him that he is ready to supply the boxes at the mentioned rate. This is an Express Contract. The same intention of the parties may be expressed in writing signed by both the parties.

9. **Implied Contract:** The evidence of an implied contract is to be deduced from the acts or conduct of the parties. No exchange of words either written or spoken takes place, but the manifestation of their intentions is inferred from their respective acts or conduct.
10. **Quasi Contracts:** These are those obligations which are imposed by the Contract Act and do not arise from a consensus between the parties. Example: 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; the obligation is imposed by law.
11. **An Executed Contract:** It is one where both the parties to a contract have discharged their respective responsibilities by performing them. All transactions of Cash sales are the examples of Executed Contracts.
12. **An Executor Contract:** It is one where one or both the parties are yet to perform their respective promises. It is partly Executed and partly Executory.
13. **Unilateral Contract:** It is one where at the time when the contract is made one party has already performed his obligation and the obligation on the part of the other party only, is outstanding. Example: A goes to a bus stand ticket counter and buys a ticket for journey. A has performed his duty under the contract i.e., to pay the scheduled fare. But the bus authority is yet to perform his promise i.e., of carrying him from one point to another. This is a Unilateral Contract.
14. **Bilateral Contract:** As against Unilateral Contract, a Bilateral Contract is one where at the time of entering into the contract both the parties to the contract are yet to perform their respective promises.

## INDIAN CONTRACT ACT

**Meaning:** "A contract is an agreement made between two (or) more parties which the law will enforce."

**Definition:** According to section 2(h) of the Indian contract act, 1872. "An agreement enforceable by law is a contract."