

HOLY CROSS HOME SCIENCE COLLEGE THOOTHUKUDI

BUSINESS LAW

UNIT- I : INDIAN CONTRACT ACT-1872

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UNIT-1
The Indian Contract Act, 1872



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The Law of Contract constitutes the most important branch of mercantile or commercial law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the civilized world. The law relating to contract is governed by the Indian Contract Act, 1872 (Act No. IX of 1872). The preamble to the Act says that it is an Act "to define and amend certain parts of the law relating to contract". It extends to the whole of India except the State of Jammu and Kashmir.

The Act mostly deals with the general principles and rules governing contracts. The Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, e.g., Indemnity and guarantee, bailment, pledge, and agency.

The term contract has been defined by various authors in the following manner:

"A contract is an agreement creating and defining obligations between the parties". - -
Salmond

"A contract is an agreement enforceable at law, made between two or more persons, by whom rights are acquired by one or more to acts or forbearances on the part of the other or others". -
Anson

"Every agreement and promise enforceable at law is a contract". -
Sir Fredrick Pollock

The Indian Contract Act has defined contract in Section 2(h) as **"an agreement enforceable by law"**.

These definitions resolve themselves into two distinct parts. First, there must be an agreement. Secondly, such an agreement must be enforceable by law. To be enforceable, an agreement must be coupled with an obligation. A contract therefore, is a combination of the two elements: (1) an agreement and 2) an obligation. While all contracts are agreements, all agreements are not contracts. An agreement which is legally enforceable alone is a contract. Agreements which are not legally enforceable are not contracts but remain as void agreements which are not enforceable at all or as voidable agreements which are enforceable by only one of the parties to the agreement. The above observation would raise a question in our minds as to what is the exact meaning of the words 'agreements' and 'contracts'.

CONTRACT - According to sec.2 (h), a contract is defined as an agreement enforceable before the law.

AGREEMENT - According to sec.2 (e), every promise or set of promises forming consideration for each other.

An agreement occurs when two minds meet upon a common purpose. They mean the same thing in the same sense at the same time. The meeting of the minds is called *consensus-ad-idem*, i.e., consent to the matter.

OBLIGATION

An obligation is the legal duty to do or abstain from doing what one has promised to do or abstain from doing. A contractual obligation arises from a bargain between the parties to the agreement who are called the promisor and the promisee. Section 2(b) says that when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted; and "a proposal when accepted becomes a promise." In broad sense, therefore, a contract is an exchange of promises by two or more persons, resulting in an obligation to do or abstain from doing a particular act, where such obligation is recognized and enforced by law.

RIGHTS AND OBLIGATIONS

Where parties have made a binding contract, they have created rights and obligations between themselves. The contractual rights and obligations are correlative, e.g., A agrees with B to sell his car for As. 10,000 to him. In this example the following rights and obligations have been created:

- (i) A is under an obligation to deliver the car to B. B has a corresponding right to receive the car.
- (ii) B is under an obligation to pay As. 10,000 to A. A has a correlative right to receive As. 10,000.

Agreements which are not Contracts

Agreements in which the idea of bargain is absent and there is no intention to create legal relations are not contracts. These are:

(a) Agreements relating to social matters: An agreement between two persons to go together to the cinema, or for a walk, does not create a legal obligation on their part to abide by it. Similarly, if I promise to buy you a dinner and break that promise I do not expect to be liable to legal penalties. There cannot be any offer and acceptance to hospitality.

(b) Domestic arrangements between husband and wife: In *Balfour v. Balfour* (1919) 2 KB 571, a husband working in Ceylone, had agreed in writing to pay a housekeeping allowance to his wife living in England. On receiving information that she was unfaithful to him, he stopped the allowance: *Held*, he was entitled to do so. This was a mere domestic arrangement with no intention to create legally binding relations. Therefore, there was no contract.

Three consequences follow from the above discussion.

- To constitute a contract, the parties must intend to create legal relationship.
- The law of contract is the law of those agreements which create obligations and those obligations which have their source in agreement.
- Agreement is the genus of which contract is the species and, therefore, all contracts are agreements but all agreements are not contracts.

PROMISE - According to sec.2 (b), when a person made a proposal to another to whom proposal is made, if proposal is assented there to.

OFFER - According to Sec.2 (a), when a person made a proposal, when he signifies to another his willingness to do or to abstain from doing something.

AGREEMENT = OFFER + ACCEPTANCE

An Agreement is a promise or a commitment or set of reciprocal promises or commitments. An Agreement involves an offer or proposal by one person and acceptance of such offer or proposal by another person. If the agreement is capable of being enforced by law then it is a contract

CONSENSUS - AD - IDEM-

According to Sec.13, meeting of minds or identity of minds or receiving the same thing in same sense at same time.

1.2 Essentials of a Valid Contract

Now let us discuss the various essential elements of a valid contract.

In terms of Section 10 of the Act, “all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object and are not expressly declared to be void”.

Thus, in order to create a valid contract, the following elements should be present:

1. Offer & acceptance.
2. Intention to create legal relationship.
3. Consensus - ad - idem.
4. Consideration.
5. Capacity to contract.
6. Free consent.
7. Legality of object.
8. Possibility of performance. & Writing & registration

The above important elements may be further analyzed as under:

1. **OFFER AND ACCEPTANCE: According to Sec.2 (a)**, when a person made a proposal, when he signifies to another his willingness to do or to abstain from doing something.

(a) Offer or Proposal and Acceptance

One of the early steps in the formation of a contract lies in arriving at an agreement between the contracting parties by means of an offer and acceptance. Thus, when one party (the offeror) makes a definite proposal to another party (the offeree) and/ the offeree accepts it in its entirety and without any qualification, there is a meeting of the minds of the parties, and a contract comes into being, assuming that all other elements are also present.

Rules Governing Offers

A valid offer must comply with the following rules:

(a) An offer must be clear, definite, complete and final. It must not be vague. For example, a promise to pay an increased price for a horse if it proves lucky to promiser is too vague and is not binding.

(b) An offer must be communicated to the offeree. An offer becomes effective only when it has been communicated to the offeree so as to give him an opportunity to accept or reject the same.

(c) The communication of an offer may be made by express words-oral or written-or it may be implied by conduct.

(d) The communication of the offer may be general or specific. Where an offer is made to a specific person it is called *specific offer* and it can be accepted only by that person. But when an offer is addressed to an uncertain body of individuals i.e. the world at large, it is a *general offer* and can be accepted by any member of the general public by fulfilling the condition laid down in the offer.

The leading case on the subject is *Carlill v. Carbolic Smoke Ball Co.* The company offered by advertisement, a reward of £ 100 to anyone who contacted influenza after using their smoke ball in the specified manner. Mrs. Carlill did use smoke ball in the specified manner, but was attacked by influenza. She claimed the reward and it was held that she could recover the reward as general offer can be accepted by anybody. Since this offer is of a continuing nature, more than one person can accept it and can even claim the reward. But if the offer of reward is for seeking some information or seeking the restoration of missing thing, then the offer can be accepted by one individual who does it first of all. The condition is that the claimant must have prior knowledge of the reward before doing that act or providing that information.

Example: A advertise in the newspapers that he will pay rupees one thousand to anyone who restores to him his lost son. B without knowing of this reward “finds A's lost son and restore him to A. In this case since B did not know of the reward, he cannot claim it from A even though he finds A's lost son and restores him to A.

In India also, in the case of *Harbhajan Lal v. Harcharan Lal* (AIA 1925 All. 539), the same rule was applied. In this case, a young boy ran away from his father's home. The father issued a pamphlet offering a reward of As. 500 to anybody who would bring the boy home. The plaintiff saw the boy at a railway station and sent a telegram to the boy's father. It was held that the handbill was an offer open to the world at large and was capable to acceptance by any person who fulfilled the conditions contained in the offer. The plaintiff substantially performed the conditions and was entitled to the reward offered.

An Offer must be distinguished from

(a) An invitation to treat or an invitation to make an offer: e.g., an auctioneer's request for bids (which are offered by the bidders), the display of goods in a shop window with prices marked upon them, or the display of priced goods in a self-service store or a shopkeeper's catalogue of prices are invitations to an offer.

(b) A mere statement of intention: e.g., an announcement of a coming auction sale. Thus a person who attended the advertised place of auction could not sue for breach of contract if the auction was cancelled (*Harris v. Nickerson* (1873) L.A. 8 QB 286).

(c) A mere communication of information in the course of negotiation: e.g., a statement of the price at which one is prepared to concede (negotiating the sale of piece of land (*Harvey v. Facey* (1893) A.C. 552).

An offer that has been communicated, properly continues as such until it lapses, or until it is revoked by the offeror, or rejected or accepted by the offeree.

Lapse of Offer Section 6 deals with various modes of lapse of an offer. It states that an offer lapses if

- it is not accepted within the specified time (if any) or after a reasonable time, if none is specified. it is not accepted in the mode prescribed or if no mode is prescribed in some usual and reasonable manner, e.g., by sending a letter by mail when early reply was requested
- the offeree rejects it by distinct refusal to accept it;
- either the offeror or the offeree dies before acceptance;
- the acceptor fails to fulfill a condition precedent to an acceptance.
- the offeree makes a counter offer, it amounts to rejection of the offer and an offer by the offeree may be accepted or rejected by the offeror.

Revocation of Offer by the Offeror

An offer may be revoked by the offeror at any time before acceptance. Like any offer, revocation must be communicated to the offeree, as it does not take effect until it is actually communicated to the offeree. Before its actual communication, the offeree, may accept the offer and create a binding contract. The revocation must reach the offeree before he sends out the acceptance. An offer to keep open for a specified time (option) is not binding unless it is supported by consideration.

TYPES OF OFFER

Express offer - When offer is given to another person either in writing or in oral.

Implied offer - When offer is given to another person neither in writing nor in oral.

Specific offer - When offer is given to a specific person.

General offer - When offer is given to entire world at a large. (Carlill Vs. Carbolic smoke ball Co.,)

Cross offer - When both the persons are making identical offers to each other in ignorance of other's offer.

Counter offer - When both the persons are making offers to each other which are not identical in ignorance of other's offer.

Standing offer - An offer which remains continuously enforceable for a certain period of time.

ACCEPTANCE- Section 2(b)

A contract emerges from the acceptance of an offer. Acceptance is the act of assenting by the offeree to an offer. **Under Section 2(b) of the Contract Act when a 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."**

Rules Governing Acceptance

- Acceptance must be given as per the mode prescribed by the offerer.
- Acceptance must be given before the lapse of time or within reasonable time.
- Acceptance must be unconditional.
- Acceptance may be given by any person in case of general offer.
- Acceptance may be given by any specific person in case of specific offer.
- Acceptance must be communicated. (Bordgon Vs. Metropolitan Rly. Co.)
- Mental acceptance is no acceptance or acceptance must not be derived from silence.
- Acceptance must not be precedent to offer.

Standing Offers

Where a person offers to another to supply specific goods, up to a stated quantity or in any quantity which may be required, at a certain rate, during a fixed period, he makes a standing offer. Thus, a tender to supply goods as and when required, amounts to a standing offer.

A standing offer or a tender is of the nature of a continuing offer. An acceptance of such an offer merely amounts to intimation that the offer will be considered to remain open during the period specified and that it will be accepted from time to time by placing order during the period specified quantities. Each successive order given, while the offer remains in force, is an acceptance of the standing offer as to the quantity ordered, and creates a separate contract it does not bind either party unless and until such orders are given.

Where P tendered to supply goods to L upto a certain amount and over a certain period, L's order did not come up to the amount expected and P sued for breach of contract *Held*: Each order made was a separate contract and P was bound to fulfill orders made, but there was no obligation on L to make any order to all (*Percival Ltd. v. L.C.C. (1918)*).

Tickets

Tickets purchased for entrance into places of amusement, or tickets issued by railways or bus companies, clock-room tickets, and many other contracts set out in printed documents contain numerous terms, of many of which the party receiving the ticket or document is ignorant. If a passenger on a railway train receives a ticket on the face of which is printed "This ticket is issued subject to the notices, regulations and conditions contained, in the current time-tables of the railway", the regulations and conditions referred to are deemed to be communicated to him and he is bound by them whether or not he has read them. He is bound even if he is illiterate and unable to read them. But it is important that the notice of the conditions i.e. contemporaneous with the making of the contract and not after the contract has been made.

Contracts by Post

Contracts by post are subject to the same rules as others, but because of their importance, these are stated below separately:

- An offer by post may be accepted by post, unless the offeror (indicates anything to the contrary.
- An offer is made only when it actually reaches the offeree and not .before, i.e., when the letter containing the offer is delivered to the offeree.
- An acceptance is made as far as the offeror is concerned, as soon as the letter containing the acceptance is posted, to offeror's correct address; it binds the offeror, but not the acceptor.
- An acceptance binds the acceptor only when the letter containing the acceptance reaches the offeror. The result is that the acceptor can revoke his acceptance before it reaches the offeror.
- An offer may be revoked before the letter containing the acceptance is posted. An acceptance can be revoked before it reaches the offeror.

Contracts over the Telephone

Contracts over the telephone are regarded the same in principle as those negotiated by the parties in the actual presence of each other. In both cases an oral offer is made and an oral acceptance is expected. It is important that the acceptance must be audible, heard and understood by the offeror. If during the conversation the telephone lines go, "dead" so that the offeror does not hear the offeree's word of acceptance, there is no contract at the moment. If the whole conversation is repeated and the offeror hears and understands the words of acceptance, the contract is complete (*KanhaiyalaJv. Dineshwarchandra (1959) AIR, M.P. 234*).

2) Intention to Create Legal Relations

The second essential element of a valid contract is that there must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. 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.

A proposal or an offer is made with a view to obtain the assent to the other party and when that other party expresses his willingness to the act or abstinence proposed, he accepts the offer and a contract is made between the two. But both offer and acceptance must be made with the intention of creating legal relations between the parties. The test of intention is objective. The Courts seek to give effect to the presumed intention of the parties. Where necessary, the Court would look into the conduct of the parties, for much can be inferred from the conduct. The Court is not concerned with the mental intention of the parties, but rather with what a reasonable man would say, was the intention of the parties, having regard to all the circumstances of the case.

For example, if two persons agree to assist each other by rendering advice, in the pursuit of virtue, science or art, it cannot be regarded as a contract. In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is rebuttable which means that it must be shown that the parties did not intend to be legally bound

3. Consensus - ad - idem: According to Sec.13, meeting of minds or identity of minds or receiving the same thing in same sense at same time.

4. According to sec 2(d) consideration is defined as “when at the desire of the promisor , or promisee or any other person has done or abstained from doing or does or abstains from doing ,or promises to do or to abstain from doing , something , such an act or abstinence or promise is called a consideration for the promise .

Example:- A agrees to sell his books to B `for100 B’s promise to pay` 100 is the consideration for A’s promise to sell his books and A’s promise to sell the books is the consideration for B’s promise to pay ` 100,

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

Rules Governing Consideration

(a) Every simple contract must be supported by valuable consideration otherwise it is formally void subject to some exceptions.

(b) Consideration may be an act of abstinence or promise.

(c) There must be mutuality i.e. each party must do or agree to do something. A gratuitous promise as in the case of subscription for charity is not enforceable. For example, where A promises to subscribe Rs. 5,000 for the repair of a temple, and then refuses to pay, no action can be taken against him.

(d) Consideration must be real, and not vague, indefinite, or illusory, eg. a son's promise to "stop being a nuisance" to his father, being vague, is no consideration.

(e) Although consideration must have some value, it need not be adequate i.e. a full return for the promise. Section 25 (Exp. II) clearly provides that "an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate." It is upon the parties to fix their own prices. For example, where A voluntarily agreed to sell his motor car for Rs. 500 to S, it became a valid contract despite the inadequacy of the consideration.

(f) Consideration must be lawful, e.g., it must not be some illegal act such as paying someone to commit a crime. If the consideration is unlawful, the agreement is void.

(g) Consideration must be something more than the promisee is already bound to do for the promisor. Thus, an agreement to perform an existing obligation made with the person to whom the obligation is already owed is not made for consideration. For example, if a seaman deserts his ship so breaking his contract of service and is induced to return to his duty by the promise for extra wages, he cannot later sue for the extra wages since he has only done what he had already contracted for: *Stilk v. Myrick* (1809).

When Consideration' not Necessary

The general rule is that an agreement made without consideration is void. But Section 25 of the Indian Contract Act lays down certain exceptions which make a promise without consideration valid and binding. Thus, an agreement without consideration is valid:

- If it is expressed in writing and registered and is made out of natural love and affection between parties standing in a near relation to each other;
- or If it is made to compensate a person who has already done something voluntarily for the promisor,
- or done something which the promisor was legally compellable to do;
- or If it is a promise in writing and signed by the person to be charged therewith,
- or by his agent, to pay a debt barred by the law of limitation.
- Besides, according to Section 185 of the Indian Contract Act, consideration is not required to create an agency.
- In the case of gift actually made, no consideration is necessary. There need not be nearness of relation and even if it is, there need not be any natural love and affection between them.

The requirements in the above exceptions are noteworthy. The first one requires written and registered promise. The second may be oral or in writing and the third must be in writing.

Illustrations: A, for natural love and affection, promises to give his son B Rs. 10,000. A put his promise to B into writing and registered it. This is a contract. A registered agreement between a husband and his wife to pay his earnings to her is a valid contract, as it is in writing, is registered, is between parties standing in near relation, and is for love and affection (*Poonoo Bibi v. Fyaz Buksh*, (1874) 15 80m LA. 57).

But where a husband by a registered document, after referring to quarrels and disagreement between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence, it was held that the promise was unenforceable, as it was not made for love and affection (*Rajlucky Deb v. Bhootnath* (1900) 4 C.W.N. 488).

Illustrations

(a) A agrees to sell his house to B for 10, 000 rupees. Here B's promise to pay the sum of 10, 000 rupees is the consideration for A's promise to sell the house, and A's promise to sell the house is the consideration for B's promise to pay the 10, 000 rupees. These are lawful considerations.

(b) A promises to pay B 1, 000 rupees at the end of six months, if C, who owes that sum to B, fails to pay it. B promises to grant time to C accordingly. Here the promise of each party is the consideration for the promise of the other party and they are lawful considerations.

(c) A promises, for a certain sum paid to him by B, to make good to B the value of his ship if it is wrecked on a certain voyage. Here A's promise is the consideration for B's payment and B's payment is the consideration for A's promise and these are lawful considerations.

(d) A promises to maintain B's child and B promises to pay A 1, 000 rupees yearly for the purpose. Here the promise of each party is the consideration for the promise of the other party. They are lawful considerations.

(e) 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 void, as its object is unlawful.

(f) A promises to obtain for B an employment in the public service, and B promises to pay 1, 000 rupees to A. The agreement is void, as the consideration for it is unlawful.

(g) A, being agent for a landed proprietor, agrees for money, without the knowledge of his principal, to obtain for B a lease of land belonging to his principal. The agreement between A and B is void. as it implies a fraud by concealment, by A, on his principal.

(h) A promises B to drop a prosecution which he has instituted against B for robbery, and B promises to restore the value of the things taken. The agreement is void, as its object is unlawful.

(i) A's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which the defaulter is prohibited from purchasing, the estate. B, upon an understanding with A, becomes the purchaser, and agrees to convey the estate to A upon receiving from him the price which B has paid. The agreement is void, as it renders the transaction, in effect a purchase by the defaulter, and would so defeat the object of the law.

(j) A, who is B's mukhtar, promises to exercise his influence, as such, with B in favor of C, and C promises to pay 1, 000 rupees to A. The agreement is void, because it is immoral.

There may not be 'void object' as such, but one can consider it as void contract having unlawful object which can be declared void object. Similarly, there may not be 'void consideration' as such, but one can consider it as void contract having unlawful/illegal consideration which can be declared void consideration.

5. Capacity to contract: The third element is the capacity of the parties to make valid contract. Capacity or incapacity of a person could be decided only after reckoning various factors. Section 11 of the Indian Contract Act, 1872 elaborates on the issue by providing that a person who-

- (a) has not attained the age of majority,
- (b) is of unsound mind and
- (c) is disqualified from entering into a contract by any law to which he is subject, should be considered as not competent to enter into any contract. Therefore law prohibits (a) Minors (b) persons of unsound mind [excluding the Lucid intervals] and (c) person who are otherwise disqualified like an alien enemy, insolvents, convicts etc from entering into any contract.

"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.

"A valid agreement requires that both the parties should understand the legal implications of their conduct. Thus both must have a mature mind. The legal yardstick to measure maturity, according to the law of contract is, that both should be major and of sound mind and if not, the law would presume that the maturity of their mind has not reached to the extent of visualizing the pros and cons of their acts, hence, a bar on minors and lunatics competency to contract.

The contractual capacity of a corporation depends on the manner in which it was created.

Minor's Contract

According to the Indian Majority Act, 1875, a minor is a person, male or female, who has not completed the age of 18 years. In case a guardian has been appointed to the minor or where the minor is under the guardianship of the Court of Wards, the person continues to be a minor until he completes his age of 21 years. According to the Indian Contract Act, no person is competent to enter into a contract who is not of the age of majority.

The following points must be kept in mind with respect to minor's contract:

- (a) A minor's contract is altogether void in law, and a minor cannot bind himself by a contract. If the minor has obtained any benefit, such as money on a mortgage, he cannot be asked to repay, nor can his mortgaged property be made liable to pay.
- (b) Since the contract is void *ab initio*, it cannot be ratified by the minor on attaining the age of majority.

(c) Estoppels are an important principle of the law of evidence. To explain, suppose X makes a statement to Y and intends that the latter should believe and act upon it. Later on, X cannot renege from this statement and make a new one. In other words, X will be estopped from denying his previous statement. But a minor can always plead minority and is not estopped from doing so even where he had produced a loan or entered into some other contract by falsely representing that he was of full age, when in reality he was a minor.

But where the loan was obtained by fraudulent representation by the minor or some property was sold by him and the transactions are set aside as being void, the Court may direct the minor to restore the property to the other party.

For example, a minor fraudulently overstates his age and takes delivery of a motor car after executing a promissory note in favor of the trader for its price. The minor cannot be compelled to pay the amount to the promissory note, but the Court on equitable grounds may order the minor to return the car to the trader, if it is still with the minor.

Thus, according to Section 33 of the Specific Relief Act, 1963 the Court may, if the minor has received any benefit under the agreement from the other party require him to restore, so far as may be such benefit to the other party, to the extent to which he or his estate has been benefited thereby.

(d) A minor's *estate* is liable to pay a *reasonable price* for necessaries supplied to him or to anyone whom the minor is bound to support (Section 68 of the Act).

The necessaries supplied must be according to the position and status in life of the minor and must be things which the minor actually needs. The following have also been held as necessaries in India.

Costs incurred in successfully defending a suit on behalf of a minor in which his property was in jeopardy; costs incurred in defending him in a prosecution; and money advanced to a Hindu minor to meet his marriage expenses have been held to be necessaries.

- An agreement by a minor being void, the Court will never direct specific performance of the contract.
- A minor can be an agent, but he cannot be a principal nor can he be a partner.
- He can, however, be admitted to the benefits of a partnership.
- Since a minor is never personally liable, he cannot be adjudicated as an insolvent.
- An agreement by a parent or guardian entered into on behalf of the minor is binding on him provided it is for his benefit or is for legal necessity.

Lunatic's Agreement (Section 2)

A person of unsound mind is a lunatic. That is to say for the purposes of making contract, a person is of unsound mind if at the time when he makes the contract, he is incapable of understanding it and of forming rational judgment as to its effect upon his interests.

A person unsound mind cannot enter into a contract. A lunatic's agreement is therefore void. But if he makes a contract when he is of sound mind, i.e., during lucid intervals, he will be bound by it.

A sane man who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgment as to its effect on his interests cannot contract whilst such delirium or state of drunkenness lasts. A person under the influence of hypnotism is temporarily of unsound mind. Mental decay brought by old age or disease also comes within the definition.

Agreement by persons of unsound mind is void. But for necessities supplied to a lunatic or to any member of his family, the lunatic's estate, if any, will be liable. There is no personal liability incurred by the lunatic.

Alien Enemies

A person who is not an Indian citizen is an alien. An alien may be either an alien friend or a foreigner whose sovereign or State is at peace with India, has usually contractual capacity of an Indian citizen. On the declaration of war between his country and India he becomes an alien enemy. A contract with an alien enemy becomes unenforceable on the outbreak of war.

For the purposes of civil rights, an Indian citizen of the subject of a neutral state who is voluntarily resident in hostile territory or is carrying on business there is an alien enemy. Trading with an alien enemy is considered illegal, being against public policy.

Foreign Sovereigns and Ambassadors Foreign sovereigns and accredited representatives of foreign states, i.e., Ambassadors, High Commissioners enjoy a special privilege in that they cannot be sued in Indian Courts, unless they voluntarily submit to the jurisdiction of the Indian Courts. Foreign Sovereign Governments can enter into contracts through agents residing in India. In such cases the agent becomes personally responsible for the performance of 'the contracts.

Married Women

In India there is no difference between a man and a woman regarding contractual capacity. A woman married or single can enter into contracts in the same ways as a man. She can deal with her property in any manner she likes, provided, of course, she is a major and is of sound mind.

5. 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*

According to Sec 15 coercion means “Committing or threaten to commit any act forbidden by Indian Penal Code 1860 or unlawful detaining or threatening to detaining any other person property with a view to enter into an agreement. It is immaterial whether the IPC is or is not in force where the coercion is employed” The threat amounting to coercion need not necessarily be from a party to contract, it may also proceed from a stranger to the contract.

Consent is said to be caused by coercion when obtained by:

- 1.The committing or threatening to commit any act forbidden by the Indian Penal Code
- 2.The unlawful detaining or threatening to detain any property
It is not important whether the IPC is or not in force where the coercion is taking place.

For example A and B, both Indians are on a voyage trip to America when the ship is on the Atlantic ocean B threatens that if doesn't transfer his property to B's name then he will push him into the water. Now though the IPC is not in force on the Atlantic ocean it is still considered coercion

2. Undue influence: Undue influence (Section 16): 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 of the other. A person is deemed to be in a position to dominate the will of the other, when he holds authority, real or apparent over the other, or when he stands in a fiduciary relation to other.

1. The essential ingredients of undue influence are: One of the There are two persons
2. The relations are satisfying between them
3. One must dominate the other
4. There must be unfair advantage
5. It involves the moral pressure

3. Fraud (Section 17): Fraud means and includes any of the following act committed by a party to a contract or with his connivance or by his agent with intent to deceive another party thereto or his agent or to induce him to enter into the contract.

- (i) the suggestion, as to a fact, of that which is not true by one who does not believe it be true;
- (ii) the active concealment of a fact by one, having knowledge or belief of the fact;
- (iii) a promise made without any intention of performing it;
- (iv) any other act fitted to deceive; and
- (v) any such act or omission as to law specially declared to be fraudulent. It is important to note that 'fraud' that results in a contract alone is covered by section 17 of the Act. If there is a 'fraud' but it does not result in a contract, it would not fall within the purview of the Act.

The following can be taken as *illustration of fraud*:

- ◆ A director of a company issues prospectus containing misstatement knowing full well about such mis-statement. It was held any person who had purchased shares on the faith of such misstatement can repudiate the contract on the ground of fraud.

- ◆ B discovered an ore mine in the Estate of 'A' He conceals the mine and the information about the mine. 'A' in ignorance agrees to sell the estate to 'B' at a price that grossly undervalued. The contract would be voidable of the option of 'A' on the ground of fraud.

- ◆ Buying goods with the intention of not paying the price is an act of fraud.

- ◆ It will be interesting to know that not only Contract, but Act also other Acts where specifically declared certain acts and omission as fraud. A seller of a property should disclose any material defect in the property. Concealing the information would be an act of fraud. Any other act committed to deceive is fraud.

Mere silence would amount to fraud under certain circumstances.

Although a mere silence as to facts which is likely to affect the willingness of a person to enter into a contract is no fraud, where there is a duty to speak or where his silence is equivalent to speech, then such silence amounts to fraud. This would be clearly seen from the explanation to Section 17 of the Indian Contract Act, 1872. This situation often arises in Insurance contracts.

In the case of fire insurance contract between people standing in fiduciary relationship, non-disclosure of certain information would amount to fraud as there is a duty to make special disclosure.

In the case of marine insurance policy contract, where a charterer is shipping goods of high value but fails to disclose such high value of the goods to the underwriter, there is fraud. Similarly the insurer is not bound by the policy issued by him where he is misinformed about insurance policy previously taken by the insured.

4. Misrepresentation: According to Sec 18 there is misrepresentation:

1. When a person positively asserts a fact is true when his information does not warrant it to be so, though he believes it to be true
2. When there is any Breach of duty by a person which brings an advantage to the person committing it by misleading another to his prejudice
3. When a party causes however innocently the other party to the agreement to make a mistake as to the substance of the thing which is the subject of the agreement

Example: M was a marriage broker who gave Y the photograph of a man and told him that the man was young and rich. Y conveyed the same to his daughter who agreed for the proposal. But on the day of marriage it was discovered that the man was the age of 60. There is fraud between M and Y. whereas there is misrepresentation between Y and his daughter.

5. Mistake (Sections 20 and 21)

The law believes that contracts are made to be performed. The whole structure of business depends on this as the businessmen depend on the validity of contracts. Accordingly, the law says that it will not aid anyone to evade consequences on the plea that he was mistaken. On the other hand, the law also realizes that mistakes do occur, and that these mistakes are so fundamental that there may be no contract at all. If the law recognizes mistake in contract, the mistake will render the contract *void*.

The fifth significant element that vitiates consent is 'Mistake'. Where parties to an agreement are under a mistake as to a matter of fact which is essential to the agreement, then the agreement is void. As we all know a void agreement cannot be enforced at all.

Example: 'A' agrees to sell certain cargo which is supposed to be on its way in a ship from London to Bombay. But in fact, just before the bargain was struck, the ship carrying the cargo was cast away because of storm and rain and the goods were lost. Neither of the parties was aware of it. The agreement is void. [*Couturier vs. Hasite* 5 H.L.C.673]

Mistake must be a matter of fact and not of law. Where 'A' and 'B' enter into contract believing wrongly that a particular debt is not barred by law of limitation, then the contract is valid because there is no mistake of fact but of law only. However a question on foreign law would become a matter of question of fact. Similarly the existence of a particular private right though depends upon rules of law, is only a matter of fact. For *instance* where a man promises to buy a property which already belongs to him without him being aware of it, then such a promise is not binding on him. However a family arrangements or a compromise of doubtful rights cannot be avoided on the ground of mistake of law. Yet another issue to remember in mistake is that it must be of an essential fact. Whether the fact is essential or not would again depend on how a reasonable man would regard it under given circumstances. A mere wrong opinion as to the value is not an essential fact.

While deciding whether a contract is hit by mistake or not it must be remembered that 'Mistake' is not unilateral. Both the parties should be under mistake. A unilateral mistake would not render the contract invalid. For *example* where 'A' agrees to purchase from 'B' 18 carat gold thinking it to be pure gold but 'B' was not instrumental for creating such an impression then contract between 'A' and 'B' should be treated as valid.

From the foregoing it is clear that:-

- Mistake should be a matter of fact
- Mistake should not be a matter of law
- Mistake should be a matter of essential fact
- Mistake should not be unilateral but of both the parties, and
- Mistake renders agreement void and neither party can enforce the contract against each other

6. Legality of object: The last element to clinch a contract is that the agreement entered into for this purpose must not be which the law declares to be either illegal or void. An illegal agreement is an agreement expressly or impliedly prohibited by law. A void agreement is one without any legal effects.

For Example: Threat to commit murder or making/publishing defamatory statements or entering into agreements which are opposed to public policy is illegal in nature. Similarly any agreement in restraint of trade, marriage, legal proceedings etc is classic examples of void agreements.

Transaction with *parda-nishin* women

The expression '*parda-nishin*' denotes complete seclusion. Thus, a woman who goes to a Court and gives evidence, who fixes rents with tenants and collects rents, who communicates when necessary, in matters of business. with men other than

members of her own family, could not' be regarded as a *parda-nishin* woman (*Ismail Musafee v. Hafiz Boo* (1906) 33 Cal. LR 773 and 33 I.A. 86). The principles to be applied to transactions with *parda-nishin* woman are founded on *equity and good conscience* and accordingly a person who contracts with *parda-nishin* woman has to

prove that no undue influence was used and that she had free and independent advice fully understood the contents of the contract and exercised her free will. "The law throws around her a special cloak of protection" (*Kali Baksh v. Ram Gopal* (1914) L.R. 41 I.A. 23, 28-29, 36 All 81, 89).

Unconscionable transactions: An unconscionable transaction is one which makes an exorbitant profit of the other's distress by a, person who is in a dominant position. Merely the fact that the rate of interest is very high in a money lending transaction shall not make it unconscionable. But if the rate of interest is very exorbitant and the Court regards the transaction unconscionable, the burden of proving that no undue influence was exercised lies on the creditor. It has been held that urgent need of money on the part of the borrower does not itself place the lender in a position to dominate his will within the meaning of this Section (*Sunder Koer v. Rai Sham Krishen* (1907) 34 Cal. 150, C.R. 34 I.A. 9).

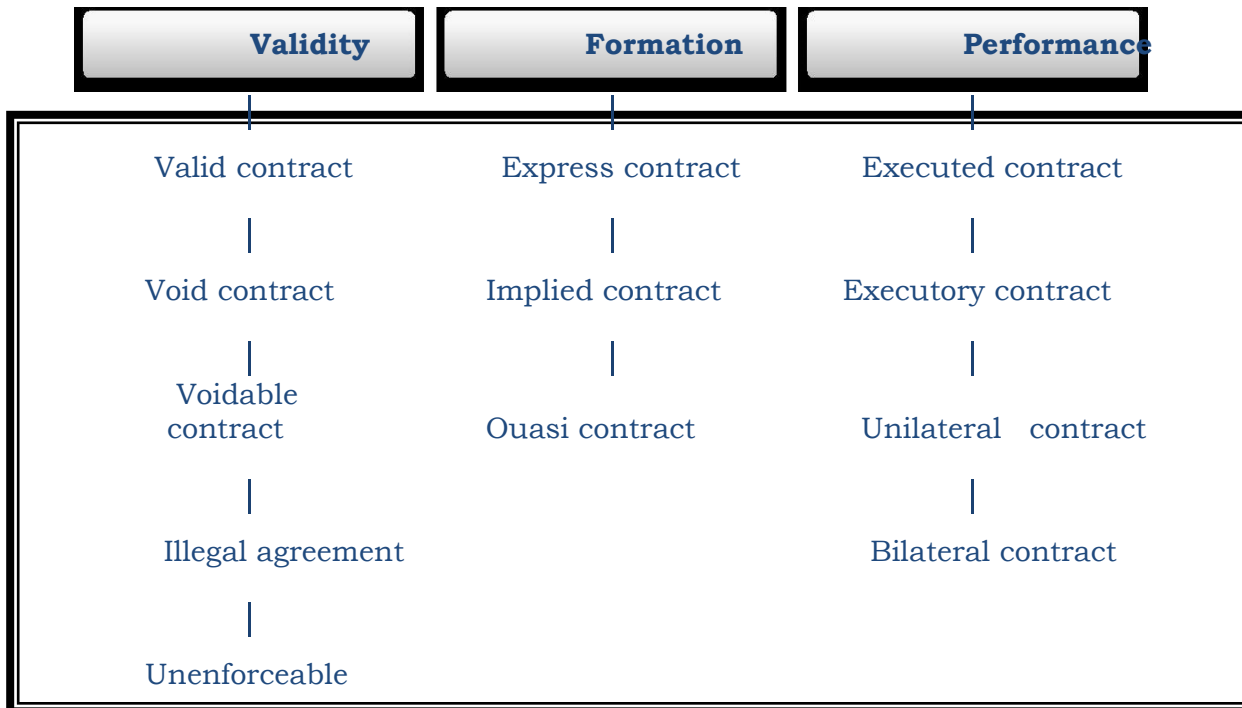
Key Points

- ◆ An agreement enforceable by law is a contract. It creates legal obligations between the parties.
- ◆ Every promise and every set of promises forming consideration for each other is an agreement.
- ◆ An agreement comes into existence when one party accepts a proposal put forward by other. In other words, agreement is promise which results from acceptance of a proposal. Thus agreement, a promise/set of promises is an accepted proposal.

Types of Contract

Now let us discuss various types of contracts

Types of Contracts on the basis of



(a) Void Agreement

A void agreement is one which is destitute of all legal effects. It cannot be enforced and confers no rights on either party. It is really not a contract at all, it is non-existent. Technically the words 'void contract' are a contradiction in terms. But the expression provides a useful label for describing the situation that arises when a 'contract' is claimed but in fact does not exist. For example, a minor's contract is void.

Features of Void agreements:

- An agreement made by incompetent parties (Incapacitated Person) is void.
- Any agreement with a bilateral mistake is void.
- Agreements which have unlawful consideration are void.
- Agreement with an unlawful object is void.
- Agreements made without consideration is void.
- Agreement in restraint of marriage of any major person is void (absolute restriction).
- Agreement in restraint of trade is void.(reasonable reason)
- Agreement in restraint of legal proceedings is void.
- An agreement the terms of which are uncertain is void.
- An agreement by way of wager (betting/gambling) is void.
- An agreement contingent upon the happening of an impossible event is void.
- Agreement to do impossible acts is void.

(b) Voidable Contract

A voidable contract is one which a party can put to an end. He can exercise his option, if his consent was not free. The contract will, however be binding, if he does not exercise his option to avoid it within a reasonable time. The consent of a party is not free and so he is entitled to avoid the contract, if he has given misrepresentation, fraud, coercion or undue influence.

(c) Illegal Agreement

An illegal agreement is one which, like the void agreement has no legal effects as between the immediate parties. Further transactions collateral to it also becomes tainted with illegality and are, therefore, not enforceable. Parties to an unlawful agreement cannot get any help from a Court of law, for no polluted hands shall touch the pure fountain of justice. On the other hand, a collateral transaction can be supported by a void agreement.

For example, one party may have deceived the other party, or in some other way there may be no genuine consent. The parties may be labouring under a mistake, or one or both the parties may be incapable of making a contract. Again, the agreement may be illegal or physically impossible. All these are called "the *FLAWS* in contract or the *VICES* of contract".