

UNIT 1

COMMERCIAL LAW

PART 1

INDIAN CONTRACT ACT, 1872

Business Law is a wide term and embraces all legal principles concerning business transactions. It is also known as the 'Commercial Law', 'Law Merchant' or 'Mercantile Law'.

Business Law consists of those legal rules, which govern and regulate the business activities, transactions and trade. It also encompasses the law relating to regulation of business associations and other incidental matters.

Definition

According to S R Davar, business law “means that branch of law which is applicable to or concerned with trade and commerce in connection with various mercantile or business transactions”.

Scope of Business Law

The following legislation enacted by Indian Legislature from time to time is covered in the Indian Business Laws:

- a) The Indian Contract Act, 1872.
- b) The Negotiable Instruments Act, 1881.
- c) The Sale of Goods Act, 1930.
- d) The Indian Partnership Act, 1932.
- e) The Insurance Act, 1972.
- f) The Arbitration & Conciliation Act, 1996.
- g) The Law of Insolvency.
- h) Law Relating to Carriage of Goods.

Sources of Business Law

The main sources of Indian Business Law are as follows:

- a) **The English Mercantile Law** [Common Laws, Equity, Roman Laws and Case Laws],
- b) **Statutes of the Indian Legislature** [Supreme and Subordinate Legislation],
- c) **Judicial Decisions & Precedents** [Declaratory, Persuasive, Absolutely Authoritative & Conditionally Authoritative Precedents],
- d) **Customs and Usage.**

THE INDIAN CONTRACT ACT, 1872

In India, the law relating to contracts is contained in the INDIAN CONTRACT ACT, 1872. The Act came into force on the 1st day of September 1872, and it applies to the whole of India except the State of Jammu and Kashmir. The act does not deal with all the branches of law of contracts. The contracts relating to Partnership, Sale of Goods Act and Negotiable Instruments Act are outside the scope of the Indian Contract Act. The Indian Contract Act deals with:

1. The general principles applicable to all contracts;
2. The conditions, which are essential for making a valid contract;
3. The principles applicable to quasi contracts;
4. The principles, which are applicable to a few special contracts, namely,
 - a) The contracts of indemnity,
 - b) The contracts of guarantee,
 - c) The contracts of bailment and agency,
 - d) The contracts of agency.

The law of contracts deals with agreements, which can be enforced through law courts. Law of contracts is the most important branch of mercantile law. It affects every person in one way or the other, as all of us enter into some kind of contract every day. The object of the law of contracts is to introduce definiteness in commercial and other transactions, and to ensure the realization of reasonable expectation of the parties, who enter into a contract.

CONTRACT

The word contract is derived from the Latin word “contractum” which means “drawn together”. It denotes a drawing together the minds of two or more persons to form a common intention giving rise to an agreement. A contract is an agreement enforceable by law, which offers personal rights and imposes personal obligations, which the law protects and enforces against the parties to the agreement.

DEFINITION

Section 2 (h) of the Indian Contract Act defines a contract as “an agreement enforceable by law”.

Therefore, a contract essentially consists of two elements:

1. **Agreement:** Section 2 (e) defines an agreement as, “every promise and every set of promises forming the consideration for each other”. In other words, an agreement is formed where one party makes the proposal and the other party accepts it.
2. **Enforceability:** Only an enforceable agreement can be called a contract. Section 10 of the Act defines “All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and a lawful object, and are not hereby expressly declared to be void”.

Sir William Anson observes, “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”.

ESSENTIAL ELEMENTS OF A VALID CONTRACT

The following are the essential elements of a contract, arrived at on the basis of a combined reading of Section 2(h) and Section 10 of the Indian Contract Act:

1. **Offer and Acceptance:** There must be a ‘lawful offer’ and ‘lawful acceptance’ of the offer, thus resulting in an agreement.

For example: If X offers to sell his Maruti Car to Y for Rs. 2,25,000 and Y agrees to pay X Rs. 2,25,000 for the Maruti Car. Here X is called the offeror or promisor and Y is the offeree or promisee.

2. **Consensus ad idem:** For a valid agreement, there must be a complete identity of minds between the contracting parties.

For example: A has two buffaloes but B is aware of only one of these. B proposes to buy the buffalo of which he is aware. A's Consents to sell the other buffalo. Since there is confusion in the minds of the parties, there is no consensus and hence no agreement follows.

3. **Free Consent:** The contracting parties must give their consent freely. It must not be given due to coercion, undue influence, fraud, misrepresentation or mistake. The absence of free consent would affect the legal enforceability of a contract.

For example: An illiterate woman executes a deed of gift under the impression that she is executing a deed authorizing her nephew to manage her agricultural land. The deed is not read or explained to her. Here, there is no consent, therefore no contract.

4. **Capacity of the parties:** The parties making the contract must be legally competent in the sense that each must be of the age of majority, of a sound mind, and not expressly disqualified from contracting (Section 11). An agreement by incompetent parties shall be a legal nullity.

For example: A, a minor, borrows Rs. 5,000 from B and executes a promissory note in B's favour. After attaining majority A executes a fresh promissory note in favour of B for this amount. B cannot sue on this promissory note as the agreement is void for lack of consideration.

5. **Lawful Consideration:** An agreement to be enforceable by law must be supported by consideration. Without consideration, a contract is regarded as a nudum pactum. Each of the contracting parties must give as well as get something. Moreover, the consideration must be lawful.

For example: X lets his house for being used as a gambling den. The agreement is illegal as the object of agreement is unlawful.

6. **Lawful object:** The object of the agreement must be lawful. It is considered unlawful if it is (i) illegal (ii) immoral, (iii) fraudulent, (iv) of a nature that, if permitted, it would defeat the provisions of any law, (v) causes injury to the person or property of another, or (vi) opposed to public policy.

For example: A promises to obtain a job for B in government service in consideration of Rs. 50,000. The agreement is void because it is forbidden by law.

7. **Not expressly declared void:** The agreement must not have been declared void by any law in force in India. The Act has itself declared void certain types of agreements such as those in restraint of marriage, or trade, or legal proceedings as well as wagering agreements.

8. **Intention to create legal relations:** There must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations.

For example: A wife withdraws a complaint against her husband under an agreement that husband will pay her allowance. Court held it as a binding contract.

9. **Certainty of meaning:** The terms of the agreement must be certain and unambiguous. Section 29 of the Act, “agreements the meaning of which is not certain or capable of being made certain are void”.

For example: A agrees to sell a car to B out of his 5 cars. There is nothing whatever to show which car was intended. The agreement is void for uncertainty.

10. **Legal formalities:** The agreement must comply with the necessary formalities as to writing, registration, stamping etc. if any required in order to make it enforceable by law.

CLASSIFICATION OF CONTRACTS

Section of the Act, which is called the ‘interpretation clause’, besides defining a contract in clause (h), also provides the basis for the classification of contracts.

Contracts may be classified as follows:

1. On the basis of Enforceability

- a) **Valid Contract:** A contract which satisfies all the legal requirements laid down in Section 10 of the Act, is a valid contract. Such a contract creates rights in personem and is legally enforceable.

- b) **Void Agreement:** Section 2(g) defines it as, “an agreement not enforceable by law is said to be void”. Such agreements are void ab initio which means that they are unenforceable right from the time they are made.

For example: X agrees with Y, in consideration of Rs. 100, to draw two parallel lines in such a way as to cross each other. The agreement is impossible to perform and, therefore void.

- c) **Void Contract:** Section 2(j) provides that "a contract which ceases to be enforceable by law becomes void when it ceases to be enforceable." Following are the examples of such circumstances which render a contract void:

- (i) Supervening impossibility or illegality as described in Section 56.
- (ii) In the case of a voidable contract when the party whose consent is not free, repudiates the contract.
- (iii) A contingent contract to do or not to do something on the happening of an event becomes void when the event becomes impossible (Section 32).

For Example: A agrees to sell 1000 tonnes of wheat to B @ Rs. 500 per tonne in case his ship reaches the port safely by 15th February. The ship fails to reach by the stipulated date. The contract between A and B is void.

- d) **Voidable Contract:** According to Section 2(i), "An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of other or others, is a voidable contract."

In a voidable contract, a right or option is open to the aggrieved party i.e., the party whose consent is not free that either to repudiate the contract or to abide by it. Thus, a voidable contract continues to be valid and enforceable till it is repudiated by the aggrieved party.

For example: A threatens to kill B if he does not give him a loan of Rs. 50,000 for 25 years. B gives the loan. This is a voidable contract as consent of B is obtained by coercion.

- e) **Illegal agreement:** An agreement which is either prohibited by law or otherwise against the policy of law is an illegal agreement. Such an agreement is a nullity and is void ab initio.
- f) **Unenforceable Contract:** An unenforceable contract is that which is valid and enforceable, but for certain technical defects such as want of proof, expiry of the period within which enforceable, absence of writing, registration and attestation, insufficient stamp etc., it becomes unenforceable.

For example: If a document embodying a contract is understamped, the contract is unenforceable, but if the requisite stamp is affixed (if allowed), the contract becomes enforceable.

2. On the basis of mode of creation

- a) **Express Contract:** An express contract is that which is made in writing or by the words of mouth.

For example: A writes to B, 'I am prepared to sell my horse for a sum of Rs. 500. B accepts A's offer by a telegram. The contract will be termed as express contract.

- b) **Implied Contract:** An implied contract is one which arises out of acts or conduct of the parties or out of the dealings between them.

For example: A takes a seat in a bus. There is an implied contract that he will pay the prescribed fare for taking him to his destination.

- c) **Quasi Contract:** Under certain circumstances, law itself creates legal rights and obligations against the parties. These obligations are known as quasi contracts.

For example: A supplies B, a lunatic with necessities suitable to his condition in life. A is entitled to be reimbursed from B's property.

3. On the basis of execution

- a) **Executed Contract:** When a contract has been completely performed, it is termed as executed contract, i.e., it is a contract where, under the terms of a contract, nothing remains to be done by either party.

For example: X sells a radio set to Y for Rs. 300. Y pays the price. Both the parties have performed their respective obligations, and therefore, it is an executed contract.

- b) **Executory Contract:** Where one or both the parties to the contract have still to perform their obligations in future, the contract is termed as executory contract.

For example: A agrees to paint a picture for B and B in consideration promises to pay A a sum of rupees one hundred. The contract is executor.

- c) **Unilateral Contract:** A unilateral contract is one sided contract in which only one party has to perform his promise or obligation to do or forbear.

For example: A, a coolie, puts B's luggage in the carriage. The contract comes into existence as soon as the luggage is put. It is now for B to perform his obligation by paying the charges to the coolie.

- d) **Bilateral Contract:** A bilateral contract is one in which both the parties have to perform their respective promises or obligations to do or forbear

For example: A promises to sell his car to B after 15 days, B promises to pay the price on the delivery of the car. The contract is bilateral as obligations of both the parties are outstanding at the time of the formation of the contract.

Distinction between Void Agreement and Voidable Contract

Basis of Distinction	Void Agreement	Voidable Contract
1. Void/illegal	All void agreements need not necessarily be illegal.	All illegal agreements are always void.
2. Effect on collateral agreements	The collateral agreements do not become void.	The collateral agreements also become void.
3. Restoration of benefit received	If a contract becomes void subsequently, the benefit received must be restored to the other party.	The money advanced or thing given cannot be claimed back.

Distinction between Void Agreement and Voidable Contract

Basis of Distinction	Void Agreement	Voidable Contract
1. Void ab initio	It is void from the very beginning.	It is valid when made and continues to remain valid till it is repudiated by the aggrieved party.
2. Enforceability	It cannot be enforced by any party.	It continues to be enforceable if the aggrieved party does not repudiate the contract.
3. Right of third party	Third party does not acquire any rights.	A third party can acquire a valid title from a person claiming under such a contract.
4. Effect of lapse of reasonable time	Even on the expiry of a reasonable time, it can never become a valid contract.	On the expiry of a reasonable time, it may become a valid contract if the aggrieved party does not repudiate the contract within reasonable time.
5. Damages	The question of damages does not arise.	The aggrieved party can claim damages.