

Introduction to the law of contract

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INTRODUCTION

Learning outcomes

The overall objective of the syllabus is to give students an understanding of the legal system and commercial laws; and build a knowledge base of corporate laws.

Introduction to the law of contract

LO **On the successful completion of this paper, candidates will be able to demonstrate knowledge of laws relating to Contract Act.**

LO 2.1.1 Define “contract”, “agreement” and “promise”

LO 2.1.2 Identify essential elements of a valid contract

LO 2.1.3 Be aware of factors which might affect the validity of a contract and their consequences

LO 2.1.4 Identify different types of a contract.

References to Legal Acts

Section number references embedded in the learning materials refer to the following legal acts unless otherwise stated:

Act	Chapters
Contract Act 1872	3-16
Partnership Act 1932	17
Negotiable Instrument Act 1881	18
Companies Act, 2017	19-26
Securities Act 2015	22

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1 INTRODUCTION TO THE LAW OF CONTRACT

Section overview

- Definition of a contract
- Essentials of a valid contract
- Classifications of contract

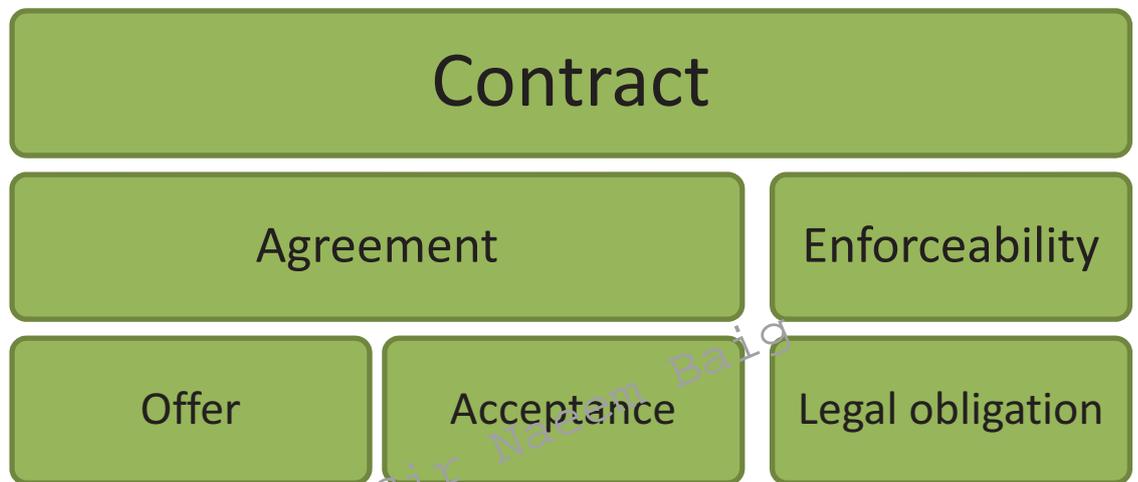
1.1 Definition of a contract



Definition: Contract [Section 2(h)]

An agreement enforceable by law is a contract.

A contract is an agreement which legally binds the parties. The analysis of the above definition reveals that a contract has following two elements:



These two essentials are discussed below:



Definition: Agreement [Section 2(e)]

Every promise and every set of promises forming the consideration for each other is an agreement.

The analysis of the above definition reveals that an agreement comes into existence only when one party makes a proposal or offer to the other party and the other party signifies his acceptance thereto. Thus an agreement can be an accepted proposal.



Definition: Promise [Section 2(b)]

When the person to whom the proposal is made signifies his assent to it, the proposal is said to be accepted. A proposal, when accepted becomes a promise.

The person making the proposal is called the promisor and the person accepting the proposal is called the promisee.



Definition: Proposal [Section 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 that other to such act or abstinence, he is said to make a proposal.

Enforceability

Every contract is an agreement, but every agreement is not always a contract. An agreement creating a legal obligation is said to be enforceable by law. The parties to an agreement must be bound to perform their promises and in case of default by either of them, must intend to sue. For an agreement to be enforceable by law there should be legal obligation instead of social, moral or religious obligation.



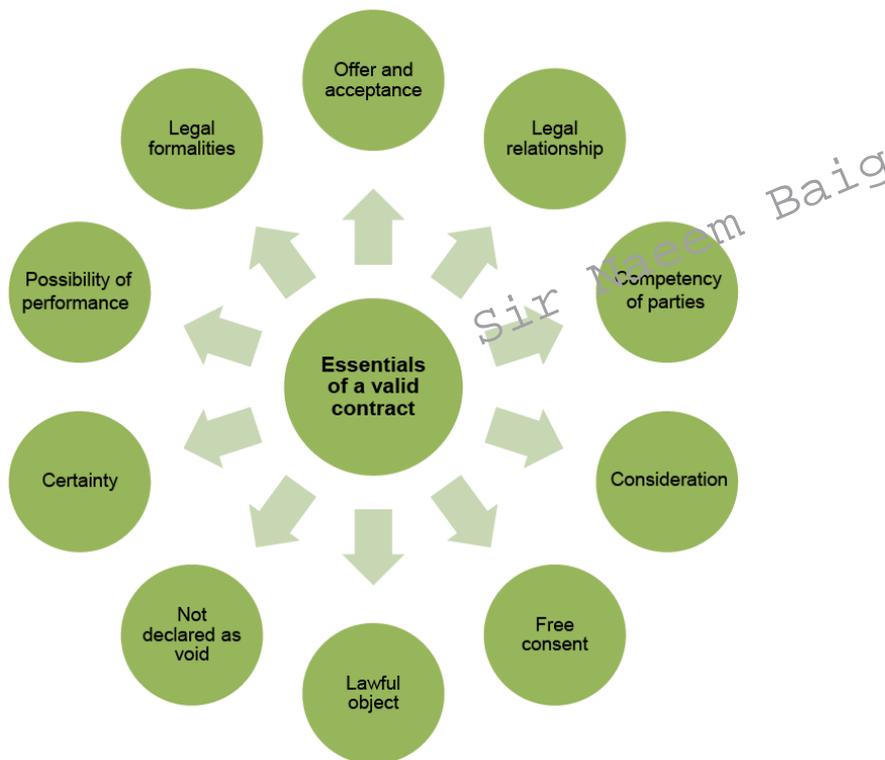
Example: Enforceability

- ❑ A, offers to sell his furniture to B for Rs. 50,000. B accepts this offer. In this agreement if there is default by either party, an action for breach of contract can be enforced through a court of law provided all the essential elements of a valid contract are present in this agreement.
- ❑ A invites B to dinner. B accepts the invitation but fails to turn up. Here, A cannot sue B for damages because the parties to this agreement do not intend to create legal obligations.

Thus, the law of contract covers such agreements where the parties intend to create legal obligations. In social, domestic, moral and religious obligation the usual presumption is that the parties do not intend to create legal obligations.

1.2 Essentials of a valid contract

The essentials of a valid contract are shown below [Section 10]:



These essentials are discussed below:

Offer and acceptance

There must be an agreement between parties to create a valid contract. An agreement involves a valid offer and its acceptance.



Example: Offer and acceptance

A offers to buy bike from B for Rs.50,000 to which B responds positively.
Here A has made an offer and B has accepted it

Offer and acceptance is discussed in detail in Chapter 3.

Legal relationship

A contract to become valid must have a legal relationship. In case of social or domestic agreements, the usual presumption is that the parties do not intend to create legal relationship but in commercial or business agreements, the usual presumption is that the parties intend to create legal relationship unless otherwise agreed upon.



Example: Legal relationship

A invited B on a dinner at his home. B accepted the invitation. It is a social agreement. If A fails to serve dinner to B then B cannot go to court for enforcing the agreement and similarly if B did not turn up then A cannot go to court for enforcing the agreement.

Competency of parties

As per section 11 the parties to an agreement must be competent to contract. In other words, the person must be of

- The age of majority
- Person of sound mind and
- Not declared as disqualified from contracting by any law to which he is subject.



Example: Competency of parties

A (Minor) borrowed Rs. 100,000 from B and executed mortgage of his property in favour of the lender. This is not a valid contract because A is not competent to contract.

Competency of parties is discussed in detail in Chapter 4.

Consideration

As per section 23 an agreement must be supported by lawful consideration. Gratuitous (without consideration) promises are not enforceable at law. Consideration requires not only presence of consideration but also lawfulness of consideration.



Example: Consideration

A offers to buy IPAD from B for Rs. 50,000 to which B responds positively.

Here A's promise to pay Rs. 50,000 is the consideration for B's promise and B's promise to sell the IPAD is the consideration for A's promise.

Consideration is discussed in detail in Chapter 5.

Free Consent

As per section 14 an agreement must be made between parties by free consent. In other words, the consent must not be obtained from following:

- Coercion
- Undue influence
- Fraud
- Misrepresentation
- Mistake



Example: Free consent

- A beats B and compels him to sell his bike for Rs. 20,000. Here, B's consent has been obtained by coercion because beating someone is an offence under the Pakistan Penal Code.


Example: Free consent (continued)

- A having advanced money to his son, B during his minority, upon B's coming of age obtains, by misuse of parental influence, a bond from B for a greater amount than the sum due in respect of the advances. A employs undue influence.

Free consent is discussed in detail in Chapter 6.

Lawful Object

As per section 23 the object of an agreement must be lawful. An object is said to be unlawful when:

- It is forbidden by law
- Is of such a nature that if permitted would defeat the provisions of any law
- It is fraudulent
- It involves an injury to the person or property of another
- The court regards it as immoral, or opposed to public policy


Example: Lawful object

- A, B and C enter into an agreement of the division among them of gains acquired, or be acquired, by them by fraud. The agreement is void, as its object is unlawful.
- A promises to obtain for B an employment in the public service, and B promises to pay Rs.10,000,000/-to A. The agreement is void as the consideration for it is unlawful.
- A, who knows that B has stolen goods amounting to Rs.500,000, receives Rs.100,000 from B in consideration of not exposing A. This agreement is illegal.

Lawful object is discussed in detail in Chapter 7.

Not declared as void

As per section 24 to 30 an agreement which is not enforceable by law is called void agreement. There are certain agreements which have been expressly declared as void such as:

- Agreement, the consideration or object of which is partly unlawful
- Agreement made without consideration
- Agreement in restraint of marriage
- Agreement in restraint of legal proceedings
- Agreement in restraint of trade
- Uncertain agreements
- Wagering agreement


Example: Not declared as void

- A and B carried on business in a certain locality in Karachi. A promised to stop business in that locality if B paid him Rs 1,000 per day. A stopped his business but B did not pay him the promised money. It was held that A could not recover anything from B because the agreement was in restraint of trade and was thus void (restraint of trade).
- A promises to pay Rs 10,000 to B if it rained today, and B promises to pay Rs 1,000 to A if it did not. The agreement is void because the happening and non-happening is dependent on future uncertain event (wager).

Void agreements are discussed in detail in Chapter 8.

Certainty

As per section 29 an agreement may be void on the grounds of uncertainty. The meaning of the agreement must be certain or capable of being certain.



Example: Certainty

- A agrees to sell to B "a hundred ton of oil." There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.
- A, who is a dealer in coconut oil, agrees to sell to B "one hundred ton of oil." The nature of A's trade affords an indication of the meaning of the words, and has entered into a contract for the sale of one hundred tons of coconut oil.
- A agrees to sell to B "all the grain in my granary at Peshawar." There is no uncertainty here to make the agreement void.
- A agrees to sell to B "one thousand mounds of rice at a price to be fixed by c." As the price is capable of being made certain, there is no uncertainty here to make the agreement void.
- A agrees to sell to B "my white horse for Rupees five hundred or Rupees one thousand." There is nothing to show which of the two prices are to be given. The agreement is void.

Possibility of performance

As per section 56 the terms of the agreement must be capable of being performed. An agreement to do an act impossible in itself is void.



Example: Possibility of performance

A agrees with B to discover treasure by magic. The agreement is void.

Legal formalities

As per section 25 an oral contract is a perfectly valid contract, except in certain cases where a contract must comply with the necessary formalities as to writing, registration etc.

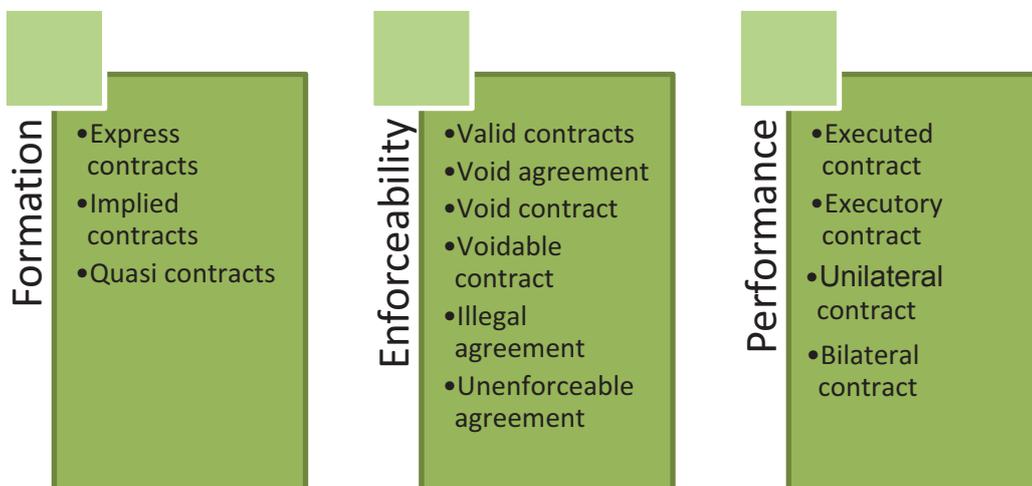


Example: Legal formalities

An oral agreement for arbitration about present disputes is unenforceable because the law requires that such arbitration agreement must be in writing.

1.3 Classifications of contract

The different classifications of contract are shown below:



The above classifications of contract are briefly discussed below:

Express contracts	A contract created by words i.e. verbally or in writing
Implied contracts	A contract created by conduct of a person or the circumstances of a particular case.
Quasi contracts	An obligation imposed by law.
Valid contract	An agreement which is enforceable by law.
Void agreement Section 2(g)	An agreement which is not enforceable by law.
Void contract Section 2(j)	A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.
Voidable contract Section 2(i)	An agreement which is enforceable by law at the option of the aggrieved party.
Illegal agreements	An agreement the object of which is illegal.
Unenforceable agreement	An agreement which is otherwise valid but due to some technical lacking, such as writing etc. remains unenforceable.
Executed contract	A contract where both the parties have performed their respective promises.
Executory contract	A contract in which something remains to be done.
Unilateral contract	A contract is which a promise on one side is exchanged for an act on the other side. In such contract one party to a contract has performed his part and performance is outstanding against the other party.
Bilateral contract	A contract in which a promise on one side is exchanged for a promise on the other.



Example: Void contract

A music hall was rented out for a series of concerts. The hall caught fire before the date of first concert. The contract was valid at the time of its formation but became void when hall caught fire.



Example: Void agreement

A (Minor) borrowed Rs. 100,000 from B and executed mortgage of his property in favour of the lender. This is a void agreement because A is not competent to contract and B cannot legally enforce against A.



Example: Voidable contract

A threatens to kill B if he does not sell his BMW for Rs 1 million to A. B contracted to sell his BMW to A and receives the payments. Here, B's consent has been obtained by coercion. Hence, this contract is voidable at the option of B but A has no right to insist that contract shall be performed.



Example: Illegal agreement

A, who knows that B has stolen goods amounting to Rs.500,000, receives Rs.100,000 from B in consideration of not exposing A. This agreement is illegal.



Example: Unenforceable agreement

An oral agreement for arbitration about present disputes is unenforceable because the law requires that such arbitration agreement must be in writing.

2 CHAPTER REVIEW

Chapter review

Before moving on to the next chapter check that you now know how to:

- Understand the meaning of a contract
- Discuss the essentials of a valid contract
- Explain the different classifications of contract

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