

THE LAW OF CONTRACT IN PAKISTAN

The general law of contract in Pakistan is contained in the Contract Act 1872 which is the main source of law regulating contracts in Pakistan. English decision's (where relevant) are also cited in the courts.

It determines the circumstances in which promise made by the parties to a contract shall be legally binding on them. All of us enter into a number of contracts everyday knowingly or unknowingly. Each contract creates some right and duties upon the contracting parties. Contract Act deals with the enforcement of these rights and duties upon the parties.

The Act defines "contract" as an agreement enforceable by law. The essentials of a (valid) contract are:

- (a) Intention to create a contract;
- (b) Offer and acceptance;
- (c) Consideration;
- (d) Capacity to enter into a contract;
- (e) Free consent of the parties;
- (f) Lawful object of the agreement;

Writing is not essential for the validity of a contract, except where a specific statutory provision requires writing. An arbitration clause must be in writing.

Definition

Section 2(h) of the Act defines the term contract as "any agreement enforceable by law". There are two essentials of this act, agreement and enforceability.

Section 2(e) defines agreement as "every promise and every set of promises, forming the consideration for each other."

Again Section 2(b) defines promise in these words: "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. Proposal when accepted becomes a promise."

Essential Elements of a Valid Contract

According to Section 10, "All agreements are contracts, if they are made by the free consent of the parties, competent to contract, for a lawful consideration with a lawful object, and not hereby expressly to be void."

Essential Elements of a Valid Contract are:

1. Proper offer and proper acceptance. There must be an agreement based on a lawful offer made by person to another and lawful acceptance of that offer made by the latter. Section 3 to 9 of the Contract Act, 1872 lay down the rules for making valid acceptance.
2. Lawful consideration: An agreement to form a valid contract should be supported by consideration. Consideration means "something in return" (quid pro quo). It can be cash, kind, an act or abstinence. It can be past, present or future. However, consideration should be real and lawful.
3. Competent to contract or capacity: In order to make a valid contract the parties to it must be competent to be contracted. According to section 11 of the Contract Act, a person is considered to be competent to contract if he satisfies the following criterion:
 - The person has reached the age of majority.
 - The person is of sound mind.
 - The person is not disqualified from contracting by any law.

4. Free Consent: To constitute a valid contract there must be free and genuine consent of the parties to the contract. It should not be obtained by misrepresentation, fraud, coercion, undue influence or mistake.
5. Lawful Object and Agreement: The object of the agreement must not be illegal or unlawful.
6. Agreement not declared void or illegal: Agreements which have been expressly declared void or illegal by law are not enforceable at law; hence does not constitute a valid contract.
7. Intention to Create Legal Relationships
8. Certainty, Possibility of Performance
9. Legal Formalities

Types of Contracts

On the basis of Validity:

1. Valid contract: An agreement which has all the essential elements of a contract is called a valid contract. A valid contract can be enforced by law.
2. Void contract [Section 2(j)]: A void contract is a contract which ceases to be enforceable by law. A contract when originally entered into may be valid and binding on the parties. It may subsequently become void.
3. Voidable contract [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. If the essential element of free consent is missing in a contract, the law confers right on the aggrieved party either to reject the contract or to accept it. However, the contract continues to be good and enforceable unless it is repudiated by the aggrieved party.
4. Illegal contract: A contract is illegal if it is forbidden by law; or is of such nature that, if permitted, would defeat the provisions of any law or is fraudulent; or involves or implies injury to a person or property of another, or court regards it as immoral or opposed to public policy. These agreements are punishable by law. These are void ab-initio.
“All illegal agreements are void agreements but all void agreements are not illegal.”
5. Unenforceable contract: Where a contract is good in substance but because of some technical defect cannot be enforced by law is called unenforceable contract. These contracts are neither void nor voidable.

On the basis of Formation:

1. Express contract: Where the terms of the contract are expressly agreed upon in words (written or spoken) at the time of formation, the contract is said to be express contract.
2. Implied contract: An implied contract is one which is inferred from the acts or conduct of the parties or from the circumstances of the cases. Where a proposal or acceptance is made otherwise than in words, promise is said to be implied.
3. Tacit contract-Tacit contracts are implied contract in itself. e.g. Taking ticket in the bus, during journey..
4. Quasi contract: A quasi contract is created by law. Thus, quasi contracts are strictly not contracts as there is no intention of parties to enter into a contract. It is legal obligation which is imposed on a party who is required to perform it. A quasi contract is based on the principle that a person shall not be allowed to enrich himself at the expense of another.

On the basis of Performance:

1. Executed contract: An executed contract is one in which both the parties have performed their respective obligation.

2. Executory contract: An executory contract is one where one or both the parties to the contract have still to perform their obligations in future. Thus, a contract which is partially performed or wholly unperformed is termed as executory contract.

3. Unilateral contract: A unilateral contract is one in which only one party has to perform his obligation at the time of the formation of the contract, the other party having fulfilled his obligation at the time of the contract or before the contract comes into existence.

4. Bilateral contract: A bilateral contract is one in which the obligation on both the parties to the contract is outstanding at the time of the formation of the contract. Bilateral contracts are also known as contracts with executory consideration.

Offer

Proposal is defined under section 2(a) of the Contract Act, 1872 as "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/offer". Thus, for a valid offer, the party making it must express his willingness to do or not to do something. But mere expression of willingness does not constitute an offer. An offer should be made to obtain the assent of the other. The offer should be communicated to the offeree and it should not contain a term the non compliance of which would amount to acceptance.

Offer and acceptance

It is an essential ingredient of a contract, that there must be an offer and its acceptance. If there is no offer, there is no contract, because there is no meeting of minds. Again, if there is an offer by one party, but it is not accepted by the other party or if the ostensible acceptance of the offer is defective, then also, there is no agreement and therefore no "contract".

These propositions may appear to be elementary. A large bulk of commercial litigation, however, requires the parties to deal with the basic questions, which are:

- (a) Whether there has there been an offer at all in the particular case, or whether there is something less than an offer;
- (b) If there is an acceptance; whether it is in the proper form;
- (c) Whether there has been an acceptance of the offer;
- (d) Whether the acceptance has been communicated to the offeror.

Classification of Offer

1. General Offer: Which is made to public in general.
2. Special Offer: Which is made to a definite person.
3. Cross Offer: Exchange of identical offer in ignorance of each other.
4. Counter Offer: Modification and Variation of Original offer.
5. Standing, Open or Continuing Offer: Which is open for a specific period of time.

The offer must be distinguished from an invitation to offer.

Invitation to offer

An invitation to offer is only a circulation of an offer; it is an attempt to induce offers and precedes a definite offer. Acceptance of an invitation to an offer does not result contract and only an offer emerges in the process of negotiation. A statement made by a person who does not intend to bound by it but, intends to further act, is an invitation to offer.

Concept of offer

An offer (or a "proposal") is not defined by statute. It is generally understood as denoting the expression, by words or conduct, of a willingness to enter into a legally binding contract as soon as it has been accepted, usually, by a return promise or an act on the part of the person (the offeree), to whom it is so addressed.

An acceptance, in relation to an offer, is a final and unqualified expression of assent to the terms of the offer.

Offer, followed by acceptance, is an "agreement", if an agreement is enforceable by law; it is a "contract".

Offer by and to whom

An offer must be made by a person legally competent to contract or on his behalf, by someone authorised by him to make the offer. It is usually made to a person (or to a number of persons), but it can be made to the entire world, as happened in *Carlill v. Carbolic-Smoke Ball. Co.*, [(1893) 1 QB 256; (1881-94) All ER 127]. In that case, the defendants (manufacturers of medicinal smoke balls) promised to pay £100 to anyone who, after having bought and used their smoke balls, caught influenza. Plaintiff did so and caught influenza. Plaintiff was held entitled to recover. It was no defence that there was no particular individual to whom the announcement was addressed. Such contracts are sometimes called "unilateral contracts" – not a very happy term, because a contract can never be "unilateral". There must be two parties. It is really a case of innumerable offers, made to all potential readers of the announcement.

Statements which are not offers

Every statement of intention is not an offer. A statement must be made with the intention that it will be accepted and will constitute a binding contract. Following are not offers:–

- (a) Statement made during negotiation, without indicating that the maker intends to be bound without further negotiation.
- (b) A statement which invites the other party to make an offer (e.g., a notice inviting tenders).
- (c) Statement of lowest price. [*Harvey v. Facey*, (1893) A.C. 552]. It is regarded as an invitation to make offers. [*Re Webster* (1975) 132 CLR 270 (Australia)].
- (d) Display of goods in a shop with price tags. (It is merely an invitation to make an offer, so that the trader may not accept the offer, if the price is incorrectly marked. [*Fisher v. Bell*, (1960) 3 All ER 731].

Intention to be bound

A definite intention to be bound is highlighted in *Gibson v. Manchester City Council*, [(1979) 1 All ER 192]. In 1970, M adopted a policy of selling council houses to tenants. In February, 1971, the City Treasurer wrote to G, stating that council "may be prepared to sell the house to you at £2,180 (freehold)". The letter asked G to make a formal application. This he did, and the council took the house off the list of council-maintained properties. Before the completion of the normal process of preparation and exchange of contracts when property is sold, control of the council changed hands and the policy of selling council houses was reversed. The new council decided only to complete those transactions where exchange of contracts had already taken place. In the UK Court of Appeal, it was held (by a majority) that a contract had been made between G and M. Lord Denning suggested that "there is no need to look for strict offer and acceptance" in every case; a price had been agreed and the parties intended to carry through the sale. However, the House of Lords held that the February letter was (at the most) an "invitation" of treat. G's application was an offer and not an acceptance. (Informal agreements for the sale of houses are not likely to be held as binding contracts, because, otherwise, buyers may find themselves committed before securing mortgage finance).

Termination of offer

Some parties clearly indicate that their statements or documents do not constitute offers, e.g., estate agents. "These particulars do not form, nor constitute any part of an offer, or a contract, for

sale". Until an offer is accepted, it creates no legal rights and it may be terminated at any time in a variety of ways. Principal modes of termination of an offer are:

- (a) by the offeror revoking (or withdrawing) it before acceptance;
- (b) by the offeree rejecting the offer outright or by making a counter-offer;
- (c) by lapse of time, if the offer is stated to be open only for a fixed time;

In *Great Northern Ry. Co. Ltd. v. Witham*, [(1873) LR 9 CP 16]. Great Northern Railway advertised for tenders for the supply of such stores as they might require for one year. W submitted a tender to supply the stores in such quantities as Great Northern Railway might order from time to time and his tender was accepted. Orders were given for some time, but eventually W given an order which he refused to carry out. It was held that W was in breach. A tender of this kind was a standing offer which was converted into a series of contracts as Great Northern Railway made their orders. W might revoke his offer for the remainder of the period covered, but must supply the goods already ordered. Revocation of an offer is effective, only when communicated to the offeree.

Acceptance

According to Section 2(b), "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted."

Rules:

1. Acceptance must be absolute and unqualified.
2. Communicated to offeror.
3. Acceptance must be in the mode prescribed.
4. Acceptance must be given within a reasonable time before the offer lapses.
5. Acceptance by the way of conduct.
6. Mere silence is no acceptance.

Quality of acceptance

Acceptance of an offer must be absolute and must correspond with the terms of the offer. This rule a key constituent of the basic premise, does not always accord with the realities of complex business contract negotiations today. Such negotiations may indeed proceed through a series of proposals, counter-proposals, withdrawals, variations and qualifications, before agreement (or otherwise) is reached. When parties carry on lengthy negotiations, it may be hard to say exactly when an offer has been made and acceptance. *Butler Machine Tool Co. Ltd. v. The Ex Cello Corp. (Eng) Ltd.* (1979) 1 WLR 401]. The court must look at the entire correspondence to decide whether an apparently unqualified acceptance did, in fact, conclude the agreement.

A conditional offer, if accepted, must be accepted along with all the conditions.

However, in regard to international agreements governed by the U.N. Convention on contracts for international sale of goods, there is a slight qualifications, in as much as, article 19 of the Vienna Convention provides that non material variations between offer and acceptance do not make a difference.

Lawful Consideration

According to Section 2(d), Consideration is defined as: "When at the desire of the promisor, the promisee has done or abstained from doing, or does or abstains from doing, or promises to do or abstain something, such an act or abstinence or promise is called consideration for the promise."

In short, Consideration means *quid pro quo* i.e. something in return.

An agreement must be supported by a lawful consideration on both sides.

The consideration or object of an agreement is lawful, unless and until it is- 1.forbidden by law, or 2.is of such nature that ,if permitted ,it would defeat the provisions of any law ,or 3.is

fraudulent ,or involves or implies injury to the person or property of another ,or 4.the court regards it as immoral ,or opposed to public policy. 5. consideration may take in any form-money, goods, services, a promise to marry, a promise to forbear etc.

Competent To Contract

Section 11 of Contract Act specifies that every person is competent to contract provided:

1. He should not be a minor i.e an individual who has not attained the age of majority i.e. 18 years.
2. He should be of sound mind while making a contract. A person with unsound mind cannot make a contract.
3. He is not a person who has been personally disqualified by law.

A person is competent to contract if, at the time of making it, he is of sound mind, major and not disqualified from contracting under law. Where he has not attained the age of 18 years (or being under a court of wards, has not attained the age of 21 years), he cannot contract. Agreements made by minors are void. Minors cannot, on attaining majority, ratify agreements entered into during their minority. But if a minor makes a fraudulent misrepresentation about his age and obtains a loan, he can be required (at the discretion of the court) to refund it or to make compensation for it. An unadjudged lunatic can enter into a valid contract during lucid intervals. A corporation can contract subject to limits imposed by its documents of incorporation.

Free Consent

According to Section 13, " two or more persons are said to be consented when they agree upon the same thing in the same sense (*Consensus-ad-idem*).

A consent is said to be free when it not caused by coercion or undue influence or fraud or misrepresentation or mistake.

As a rule, an agreement without "consideration" is void. The Act contract defines "consideration" as follows:

"When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or abstains from doing, something, such act, abstinence, or promise is called a consideration for the promise."

A mere promise to give a donation, either orally or in writing is not enforceable. Settlement of bona fide but doubtful claims involves a bargain between the contracting parties and is, therefore, based on consideration. Money is not the only form of consideration. A consideration may consist sometimes in the doing of a requested act, and sometimes in the making of a promise by the offeree. Forbearance to sue at the promisor's desire constitutes good consideration.

Consideration is not required for a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor or something which the promisor was legally compellable to do. It is also not required for a written and signed promise by the debtor (or his duly authorised agent) to pay a time-barred debt to the creditor.

Consent

When consent of a party to a transaction is procured by coercion, undue influence, fraud or misrepresentation, the agreement is voidable at the option of the party whose consent was so procured. Cases of undue influence arise where the transaction is ex facie unconscionable and one party was in a position to dominate the will of the other. Where parties are bound by a fiduciary relationship, (as in the case of father and son, doctor and patient, master and servant,

advocate and client), the law protects the weaker party, throwing on the other party the burden of proving that no undue influence was exercised.

Mutual mistake in respect of material facts in the formation of a contract renders the agreement void. A unilateral mistake, however, does not render an agreement void. Nor does a mistake of law affect its validity.

Elements Vitiating free Consent

1. Coercion (Section 15): "Coercion" is the committing, or threatening to commit, any act forbidden by the Indian Penal Code, or the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

2. Undue influence (Section 16): "Where a person who is in a position to dominate the will of another enters into a contract with him and the transaction appears on the face of it, or on the evidence, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall lie upon the person in the position to dominate the will of the other."

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

4. Misrepresentation (Section 18): "causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement".

5. Mistake of fact (Section 20): "Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void".

Revocation of offer

A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards. An acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.

A proposal is revoked -

- (1) by the communication of notice of revocation by the proposer to the other party;
- (2) by the lapse of the time prescribed in such proposal for its acceptance, or, if no time is so prescribed, by the lapse of a reasonable time, without communication of the acceptance;
- (3) by the failure of the acceptor to fulfill a condition precedent to acceptance; or
- (4) by the death or insanity of the proposer, if the fact of the death or insanity comes to the knowledge of the acceptor before acceptance.

Unlawful agreements

An agreement, whose consideration or object is unlawful, is void. The consideration or object of an agreement is unlawful, if it is forbidden by law or it would defeat the provisions of any law or is fraudulent, or involves or implies injury to the person or property of another or the court regards it as immoral or opposed to public policy.

A party to an illegal agreement who has advanced money under it to the other party is entitled to recover it, if the illegal purpose has not been partly or wholly carried out.

Agreements in restraint of marriage, trade and legal proceedings are void. The seller of the goodwill of a business may, however, validly agree with the buyer to restrain from carrying on a similar business within specified local limits, provided the limits are reasonable.

Persons bound by the contract

Promises bind the promisors and in case of death of promisor (before performance) their legal representatives, unless there is contract to the contrary, or the nature of the contract is such that it depends upon the personal qualifications of any party.

Performance and frustration

There are special provisions dealing with the case where time is the essence of contract. In commercial contracts, it is better to provide specifically that time is of the essence. A contract is validly discharged by faithful performance, by release or remission by the promisee, by "frustration" (under law) or by "Novation" (by agreement).

Frustration occurs when unexpected developments subsequent to the making of the contracts render performance impossible. Novation occurs when the old agreement is replaced by a new agreement.

Subsequent events and frustration

If, subsequent to the making of the contract, some event happens, which the parties could not control so that the agreement cannot be performed, the contract is said to be frustrated, because the contract then becomes impossible of performance. Frustration may occur by a change in the law, destruction of the subject-matter, supervening incapacity of the contracting party to perform the contract or fundamental change in circumstances after the contract is made. Mere strike, lock-out in the factory, rise in price of the contracted goods or other commercial difficulties does not, as such, render the contract "impossible" of performance.

Introduction of the permit system by statute does not absolve the promisor from supplying the goods. He must make reasonable efforts to procure the permit to fulfill his agreement. Change in market conditions also does not justify a supplier in demanding a price higher than that stipulated, unless there is an "escalation" clause.

Frustration leads to automatic termination of the contract, and exempts the parties from performance or further performance of the contract without rendering any of them liable for damages. Where, however, any party has received any benefit under the agreement, he must restore it or make compensation for it to the other party.

Agency

In law, the relationship that exists when one person or party (the principal) engages another (the agent) to act for him, e.g. to do his work, to sell his goods, to manage his business. The law of agency thus governs the legal relationship in which the agent deals with a third party on behalf of the principal. The competent agent is legally capable of acting for this principal vis-à-vis the third party. Hence, the process of concluding a contract through an agent involves a twofold relationship. On the one hand, the law of agency is concerned with the external business relations of an economic unit and with the powers of the various representatives to affect the legal position of the principal. On the other hand, it rules the internal relationship between principal and agent as well, thereby imposing certain duties on the representative (diligence, accounting, good faith, etc.).

Under section 201 to 210 an agency may come to an end in a variety of ways:

- (i) By the principal revoking the agency – However, principal cannot revoke an agency coupled with interest to the prejudice of such interest. Such Agency is coupled with interest. An agency is coupled with interest when the agent himself has an interest in the subject-matter of the agency, e.g., where the goods are consigned by an upcountry constituent to a commission agent for sale, with power to recoup himself from the sale proceeds, the advances made by him to the principal against the security of the goods; in such a case, the principal cannot revoke the agent's authority till the goods are actually sold, nor is the agency terminated by death or insanity. (Illustrations to section 201)
- (ii) By the agent renouncing the business of agency;
- (iii) By the business of agency being completed;

(iv) By the principal being adjudicated insolvent (Section 201 of Contract Act. 1872).

The principal also cannot revoke the agent's authority after it has been partly exercised, so as to bind the principal (Section 204), though he can always do so, before such authority has been so exercised (Sec 203).

Further, as per section 205, if the agency is for a fixed period, the principal cannot terminate the agency before the time expired, except for sufficient cause. If he does, he is liable to compensate the agent for the loss caused to him thereby. The same rules apply where the agent, renounces an agency for a fixed period. Notice in this connection that want of skill continuous disobedience of lawful orders, and rude or insulting behavior has been held to be sufficient cause for dismissal of an agent. Further, reasonable notice has to be given by one party to the other; otherwise, damage resulting from want of such notice, will have to be paid (Section 206). As per section 207, the revocation or renunciation of an agency may be made expressly or impliedly by conduct. The termination does not take effect as regards the agent, till it becomes known to him and as regards third party, till the termination is known to them (Section 208).

When an agent's authority is terminated, it operates as a termination of subagent also (Section 210).

Remedies for breach of contract

The principal remedies for breach of contract are:

- (a) damages;
- (b) specific performance of the contract; and
- (c) injunction.

When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, being loss or damages which naturally arose in the usual course of things from such breach or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss of damage sustained by reason of the breach.

The same principle applies for determining damages for breach of an obligation arising from quasi-contract.

In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account. This is referred to, as the duty to mitigate.

Illustration

A stipulation for increased interest from the date of default may be regarded as a stipulation by "way of penalty", if the amount is excessive. The court is empowered to reduce it to an amount reasonable in the circumstances.

Specific performance and injunctions

In certain special cases dealt with in the Specific Relief Act, 1877, the court may direct against the party in default "specific performance" of the contract, that is to say, the party may be directed to perform the very obligation which he has undertaken, by the contract. This relief is awarded only in exceptional cases.

That Act also deals with permanent injunctions. Temporary injunctions are governed by the provisions of order of the Code of Civil Procedure, 1908.