Advanced Contracts, Tendering and Public Procurement
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Lecture 9: Formation of Contract - Capacity & Consideration

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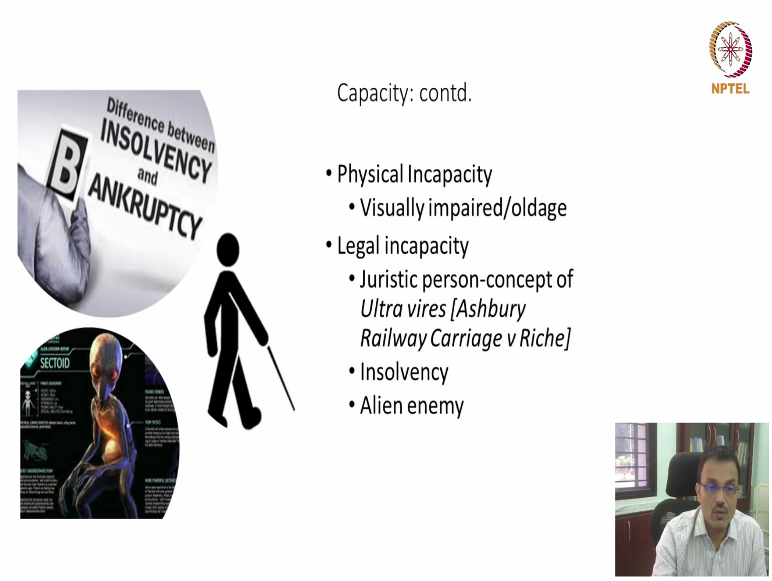

When discussing the incorporation of a company, we refer to the memorandum of association and articles of association. These two documents are prepared by the company's promoters and submitted to the registrar of companies for evaluation. In the memorandum of association, an important aspect is the main clause where the company's name is chosen. It is crucial for the name to be unique, as it serves as the company's identity.

Similarly, the articles of association outline how the company manages its affairs. They cover various aspects such as the powers and responsibilities of the board of directors, who act as representatives of the company and make it operational. The company itself cannot act independently and relies on individuals to act on its behalf.

The articles of association also address important matters such as the allocation of powers among board members, the requirements for special resolutions versus ordinary resolutions, and other key guidelines for the company's functioning. These two documents, the memorandum of association and articles of association, are essential for establishing a company and define its legal capacity.

In a similar vein, universities have statutes that govern their formation and operation. These statutes act as regulatory documents, determining the authority and limitations of key roles within the university. For instance, the vice chancellor's capacity and responsibilities are specified in the statutes, including interactions with the registrar, who has their own functional capacities. It is crucial for all individuals within the company or university to operate within their designated capacities. This ensures that the company or university functions effectively within its defined framework.

The concept of intra vires and ultra vires is significant in various areas of law, including corporate law. Intra vires refers to actions within the authorized capacity or authority, while ultra vires pertains to actions that go beyond the authorized capacity or authority. Ultra vires actions are those that are not permitted or fall outside the scope defined by the incorporating or registration documents. The capacity of an entity is assessed based on these documents, and actions are categorized as either intra vires or ultra vires accordingly. It is important to note that unless a company has the capacity to enter a contract, any action it takes may be considered ultra vires.

For instance, a notable case illustrating this concept is Ashbury Railway Carriage Company v. Riche. Companies typically include an object clause in their memorandum that defines their fundamental purpose, specifying what they should and should not do. If the object clause of a railway carriage company states that its purpose is to provide for the production and maintenance of railway carriages, entering into a contract for a different purpose not defined in the object clause would constitute an ultra vires action. Every company establishes its own object clause, such as a software company defining its object clause as being in software services. It is important for the object clause to provide some flexibility to accommodate business expansion. However, if a company engages in activities beyond the scope mentioned in the object clause, it is necessary to amend the clause accordingly. The capacity of juristic persons plays a critical role in determining their contractual capacity.

Another crucial aspect to consider is insolvency. Solvency indicates the presence of capacity, while insolvency signifies the loss of capacity. Insolvency occurs when an individual or entity has more debts than assets and is unable to settle those debts from their available assets. Once declared insolvent, the capacity to contract is lost.

In contemporary times, we have the Insolvency and Bankruptcy Code of 2016, which governs corporate insolvency and bankruptcy. While companies no longer hold the same position in contracts due to this code, it is important to note that there is no absolute prohibition for contracts involving insolvent or bankrupt companies. The remaining assets must still be disposed of, and efforts should be made to settle as much debt as possible.

However, complete capacity is not retained in cases of insolvency. Insolvency disqualifies individuals, both legally and practically, from contracting. In such situations, the capacity to contract is transferred to an official liquidator or determined by the National Company Law Tribunal (NCLT). The NCLT decides which contracts are permissible and oversees the sale of assets belonging to insolvent individuals or companies.

Insolvency fundamentally affects the capacity to contract, and unless there is legal intervention or protection, the assets of an insolvent entity cannot be dealt with, and the capacity to contract is revoked.

Furthermore, there is the traditional concept of an "alien enemy," which generally prohibits contracting with an enemy state. Once a country is declared an enemy state, individuals from that state are considered enemies, and contracting with them is not recognized in the realm of contractual capacity. This exclusion is in place to safeguard national interests. Today, international law has developed sanctions that prohibit contractual relationships with entities in violation of these sanctions. For instance, during the crisis in Ukraine, many countries-imposed sanctions on Russia, affecting contracts with Russian citizens and companies. Contracts formed after the imposition of sanctions are rendered ineffective. These sanctions demonstrate how the capacity to contract is impacted by international law in certain circumstances.

This concludes our discussion on the capacity of parties to contract, covering minors, unsound persons, individuals lacking legal capacity, and juristic persons. Moving forward, we should delve into the chapter of consideration, which is an essential aspect of contracts.

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Moving forward, another crucial aspect of contract enforcement is the consideration test. Section 25 of the Indian Contract Act states that without consideration, a contract cannot exist. Consideration holds such significance that the absence of it renders an agreement unenforceable under the law.

So, what happens if a contract lacks consideration? It means that the agreement is not legally binding. Consideration, in the context of contracts, refers to the price or value that supports the promise or agreement between parties engaged in a commercial relationship. Typically, consideration is seen as the price paid by the buyer to the seller in exchange for goods or services. It is often associated with monetary payment in commercial transactions.

However, consideration has a broader understanding. It can encompass any interest, right, detriment, loss, or even efforts undertaken in the contract. It is not solely limited to monetary or economic value. For example, consideration can be the relinquishment of a right or interest by one party or the incurring of a loss or detriment. Additionally, consideration can also arise from acts of charity or making a gift, as they may provide a sense of satisfaction to the giver.

Therefore, consideration is not solely confined to monetary exchange but extends to various forms of value, interest, or loss within the context of a contract. It is an essential element to establish the enforceability of a contract.

Consideration has a broad context, and it is important to note that under the Contract Act (as provided in Section 2(d)), it can encompass an act itself. Therefore, if I perform an act in furtherance of a promise, that act becomes consideration. For instance, if you make an offer asking me if I can run 10 kilometers within 30 minutes, my act of running becomes both consideration and acceptance of the contract. By completing the run within the specified time, I have supported the contract with consideration, and I would be entitled to the contents of your offer.

Understanding consideration also leads to the justification for enforcing the contract. In common law, judges sought a reason or justification to enforce the law, which came in the form of consideration. The actions, talk, or other contributions of the other party could serve as justification for enforcing the promise. Consideration, in this sense, was the basis for enforcing the promise, and it needed to be something of value, commercially viable, and deemed valuable by the courts and judges.

Consideration can be seen as a "quid pro quo" arrangement. If you expect me to fulfill my promise, the question arises: What have you done in exchange for the fulfillment of that promise? If you have provided something in return, then consideration has been given, and the law can be enforced. This concept of consideration has evolved over time, shaping the understanding and enforcement of contracts.

Consideration is crucial in ensuring the legality of a contract. It is important to note that in the context of contracts, the term "quid pro quo" refers to something given in exchange for the enforcement of a contractual obligation, rather than the understanding of corruption allegations.

When considering what constitutes consideration in contract law, several possibilities arise. It could be the monetary value of the contract, a sum paid by one party to another, the consideration of the contract terms before agreeing to them, or the price paid by each party for the other's promise or performance. To a large extent, consideration can encompass all of these possibilities, highlighting its wide scope.

To understand consideration, we must acknowledge that the law establishes a strict rule requiring consideration for a contract to exist. However, Section 25 of the law provides certain exceptions. For instance, consideration is not required in relationships based on love and affection, as seen in the Balfour v. Balfour case. Additionally, if a contract is put in writing and registered, it may not necessitate consideration, as the act of registration implies a commercial understanding.

Exceptions exist to the strict rule of consideration. For example, in the case of a gift, the recipient may not provide any consideration in return. Certain domestic relationships, based on love and affection, may not require consideration if the promises are put in writing and registered. In such cases, the wife, for instance, may not need to seek consideration for maintenance from her husband if the agreement is formalized in writing.

Consideration operates through these exceptions, which highlight the flexibility of the concept in specific circumstances.

Today, the exceptions to the rule of consideration have become more prevalent than the rule itself. In modern contract forms, the requirement of consideration is often dispensed with, unless challenged. This is because most modern commercial contracts are written and may even involve registration. In such cases, consideration is rarely debated or tested. However, it remains essential in cases where oral contracts are made, and that is how the significance of consideration has evolved over time.

To illustrate the importance and application of the consideration test, let's consider an interesting case. Imagine a company that sells chocolates introduces a promotional scheme. Under this scheme, they announce that if customers return the chocolate wrappers to the company, they will be eligible for an additional prize. For instance, if a customer sends back 100 wrappers, they would receive a reward. This scheme was likely devised by Nestle company.

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Continuing our exploration of consideration as an essential element for validating a contract, we encounter two significant principles and doctrines: the privity of contract and the doctrine of promissory estoppel.

Privity of contract refers to determining who should possess rights under a contract. Although this concept traditionally carries conservative implications, it holds considerable relevance in modern-day contracts. According to the strict rule, only the parties involved in a contract should have the right to sue each other. For instance, if you and I enter a contract, we are the only ones entitled to sue each other. However, questions arise when third parties become involved in a contract.

To illustrate this with a modern example, let us consider a scenario where I enter into a contract with you for certain services, but you employ a subcontractor to assist in fulfilling the contract. If the subcontractor faces non-payment or encounters other challenges, can they sue either you or me? After all, their work is derived from our contract. This issue extends to the right to invoke arbitration as well, given that many modern contracts include arbitration clauses.

The strict rule of privity does not grant any rights to third parties who are not signatories to the contract. However, common law has developed exceptions to this rule since there are circumstances where parties seek or should be granted rights in a contract.

To provide a simple example, let's assume you are a bank, and I have taken a loan from you under a contract. The loan tenure is three years, and I am obligated to repay the principal amount along with interest. Now, suppose I pass away unexpectedly. Will my son or daughter have rights to claim the loan returns? Inheritance and succession of property come into play here. Contracts made by deceased individuals must recognize the rights of their successors, even though they are not parties to the original contract. However, when we discuss rights, we also consider liabilities.

The concept of third-party rights is intriguing because, under the principle of consideration, we argue that only the parties involved in the contract have provided consideration to each other. Therefore, those who have provided consideration have the right to sue. Third parties, on the other hand, have not provided consideration, so why should they have rights? This is the underlying logic behind the privity doctrine.

However, it is important to note that if a third party can demonstrate that they have provided consideration, they can approach the court and assert their right to sue. Consider the case of a subcontractor who has contributed their labor and skills to a construction project, such as plumbers, electricians, masons, or carpenters. Even if they are not direct parties to the contract, their work has already been performed. Regardless of their formal contractual status, they have rights and duties related to the project, and thus they should have the right to sue. In this way, third parties can secure employment opportunities.

The Dunlop tire versus Selfridge case serves as a classic example where the tire company had a contract with a wholesaler, who in turn had a contract with a retailer. The question was whether the tire company could sue the retailer, or conversely, whether the retailer could sue the tire company without involving the wholesaler as the intermediary party.

Generally, if there is an unbroken chain of contracts from party A to party B, and then from party B to party C, it allows party A to sue party C or vice versa. This dilution of privity enables certain third parties to sue under the contract. Additionally, the Specific Relief Act of 1963 grants third parties the ability to bring certain claims in a contract.

The common law was initially fixated on the doctrine of privity, which excluded third parties. However, as difficulties and practical situations arose, exceptions to the doctrine were recognized. Parties who are part of the contract chain and whose obligations have not been severed are granted rights. For instance, even if a retailer does not have a direct contract with

Dunlop, they are still handling Dunlop's brand and selling their goods. The retailer acts on behalf of both the wholesaler and the tire manufacturer, establishing the role of third parties as recognized by the doctrine of consideration in Indian law.

Let us consider another example to illustrate the involvement of third parties. Suppose you want to have your house painted, and I am the painter contracted for the job. I need to purchase paint, so I go to the shop and make the transaction. Although the contract is between me and the paint shop, it is ultimately for your benefit as the homeowner. If the paint turns out to be defective, you, as the final consumer and beneficiary of the contract, have the right to sue the paint shop for any quality issues, despite not being a direct party to the contract.

The privity doctrine plays a crucial role in determining who has the right to sue in a contract. While supporting a contract with consideration traditionally grants the right to sue, there are situations where parties should be granted this right even without providing consideration. For example, if a contract includes a minor as a named beneficiary, they have the right to sue despite not being a party to the contract. These exceptions to the privity principle allow third parties to assert their rights.

It is important to note that third-party rights in contracts can also be used as a defense to exclude parties' claims and rights. However, if a party can demonstrate consideration and beneficial interest from the contract, the courts usually recognize their rights and provide contractual remedies.

Insurance contracts provide an interesting example of third-party rights. In cases of third-party insurance, such as insuring your car, the contract is between you and the insurance company. However, the beneficiary of this insurance is any third party who may be involved in an accident with your vehicle. Although the specific third party is unknown and may or may not make a claim, they can claim or sue based on the insurance policy.

There are numerous instances where third parties have been granted rights through separate statutes, such as the negotiable instrument act. For example, if I have an account with a bank and issue a check to a third party, that third party can sue the bank if the check is not cleared. Similarly, under the insurance instrument act and trust law, rights have been created for third parties. In trust law, the trustee manages for the beneficiary who is not directly involved in the transaction but benefits from it.

Another example is found in personal law, where partitions between brothers include provisions for the marriage expenses of their sister. In such cases, the sister can sue based on the family partition deal if she is named in the agreement. These rights granted through statutes and customs demonstrate how third-party issues are brought into the legal system. Third parties can assert their rights if they can prove a beneficial claim or an adverse impact on their rights in the contract.

However, it is important to consider the privity principle, as it can sometimes serve as a defense against the rights of third parties. Now, let us discuss the doctrine of promissory estoppel in relation to consideration. This doctrine holds relevance in government contracts, tendering, and public procurement. It has often been applied against the government to ensure that it fulfills its promises.

A notable case in this context is the 1979 judgment of Motilal Padampat Sugar Mills versus the state of U.P., delivered by former Chief Justice of India, late Shri Bhagwati. In this case, the government of Uttar Pradesh had promised a three-year tax holiday to any new industry established in the state. Motilal Padampat Sugar Mills sought clarification from the Secretary of the industry, who confirmed that the tax holiday would apply to them.

Acting upon this promise, the sugar mill purchased land and prepared to start their factory. However, when a new government came into power, they reversed the decision, citing loss to the exchequer. Challenged by this reversal, the sugar mill approached the court, arguing that the promise should be binding as they had already acted on it. The Supreme Court, at that time asserting its independence, ruled in favor of the sugar mill, stating that promises made by the government should not be changed retrospectively to the detriment of individuals or corporations.

Promissory estoppel, derived from the concept of estoppel, holds that someone can be stopped from denying a statement, claim, or promise they made in the past. The doctrine extends this principle to contractual promises, preventing parties from changing a promise that has been acted upon to the detriment of the other party. This principle is often invoked in government contracts to ensure contractual certainty, even in cases where the government changes.

However, it is essential to note that promissory estoppel is not an absolute rule. Courts have clarified that legislative changes can bring about changes in contracts, and the doctrine applies specifically to executive actions by the government. Legislative changes can be made if a contract is deemed against public policy or national security. Legislative actions are not subject to estoppel, while executive actions for contracts are bound by the rule of promissory estoppel.

Promissory estoppel is a significant doctrine that originated from the consideration chapter and has been applied to modern-day government contracts. There are numerous cases involving government contracts that utilize this doctrine. In conclusion, consideration is a critical aspect of contracts, and without it, a contract is not valid. We have discussed different types of consideration, the importance of adequacy, as well as concepts like privity and promissory estoppel. Now, let's move on to another crucial aspect. It is worth mentioning the 108th Law Commission report, which delves into promissory estoppel.

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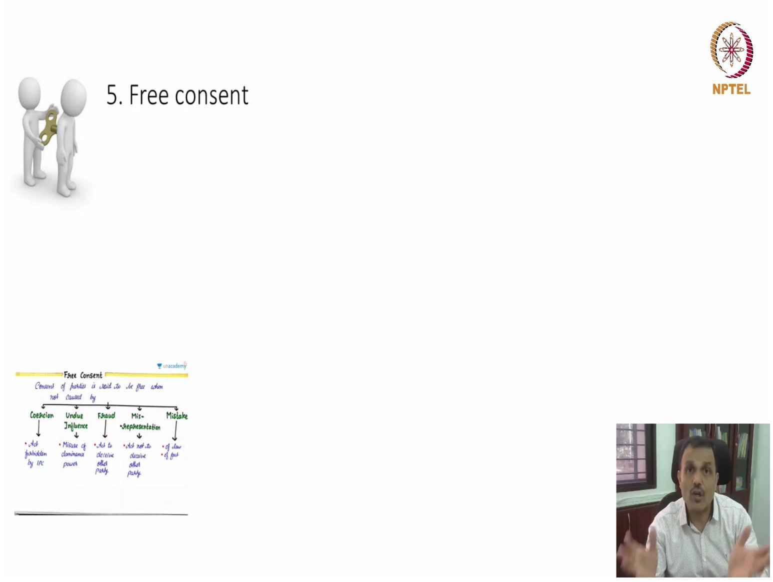

Consent is important to recognize that parties involved in a contract have a private relationship, distinct from public discourse or matters of citizenship, constitutional law, or administrative law. Contracts fall under the realm of private law, where entering a contract is a voluntary choice and cannot be forced upon anyone.

Free consent is a fundamental requirement for a valid contract. It must be ensured that both parties have agreed to the contract willingly and of their own volition. If one of the parties claims in court that they were coerced into the contract, the court will consider the contract unenforceable or voidable, rather than outright void.

If the consent of either party is tainted by factors such as coercion, undue influence, fraud, misrepresentation, or mistake, they can seek legal recourse and argue that the contract should not be enforced against them. This is because they did not genuinely agree to the contract with their free will and choice. Therefore, consent plays a crucial role in determining the validity of contracts.

Understanding the concept of consent is essential in the realm of contracts. It ensures that parties enter into agreements voluntarily and without any external pressures.