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**ALLAMA IQBAL OPEN UNIVERSITY, ISLAMABAD**

**Course: Mercantile Law (460) • Level: AD/ADC**

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**Assignment No. 1 (Units 1–4)**

**Total Marks: 100 • Pass Marks: 50**

**SOLVED ASSIGNMENT GUIDE**

**(For Study & Reference)**

*Note: This guide is prepared for study and reference purposes. Students are advised to read the relevant units of the course book, understand the concepts, and write the assignment in their own words.*

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## Question 1: Types of Contracts under the Contract Act, 1872 (20 Marks)

*Keeping in view the Contract Act 1872, explain the different types of contracts.*

### Introduction

Business life in Pakistan is built upon contracts. A shopkeeper who orders stock, a student who buys a mobile phone on instalments, a farmer who agrees to sell his wheat crop next month and a company that hires a contractor to build its warehouse are all entering into contracts, whether they realise it or not. The law that governs these agreements is the Contract Act, 1872, which applies to the whole of Pakistan. Section 2(h) of the Act defines a contract as “an agreement enforceable by law”. Two ideas are therefore joined in every contract: first, an agreement, which Section 2(e) explains as every promise and every set of promises forming the consideration for each other; and secondly, enforceability by law, which separates a contract from a mere social or domestic promise. Because commercial dealings take many shapes, the law classifies contracts in several ways — according to how they are formed, according to their validity, according to their performance and according to their form. This classification is not an



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academic exercise only. The type of a contract decides whether a court will enforce it, whether an injured party can withdraw from it, and what remedies are available when things go wrong. This answer explains each class with examples drawn from ordinary Pakistani business life.

## Contracts According to Formation

### 1. Express Contracts

An express contract is one in which the offer and its acceptance are made in words, either spoken or written. When a customer in a Lahore electronics market says, "I will pay Rs. 85,000 for this laptop," and the shopkeeper replies, "Agreed," an express oral contract is formed. If the same bargain is recorded in a signed sale deed, a written agreement or even an exchange of emails, it is an express written contract. Most formal business documents — agency agreements, supply contracts, rent deeds and employment contracts — fall in this class. Express contracts are preferred for valuable transactions because their terms can be proved easily and disputes about what was agreed are reduced.

### 2. Implied Contracts

An implied contract arises not from words but from the conduct of the parties or the circumstances of the case. When a passenger boards a bus in Karachi and travels to his destination, he impliedly promises to pay the fare, and the transport company impliedly promises to carry him safely; neither side signs or says anything. Similarly, a customer who takes a meal in a restaurant, a patient who is treated in a clinic, or a trader who accepts delivery of goods regularly supplied to his shop is bound by an implied contract. The law reads the agreement from behaviour: where a person enjoys the benefit of work done or goods

supplied in circumstances showing that payment was expected, he must pay a reasonable price for them.

### 3. Quasi-Contracts

A quasi-contract is not a contract in the real sense at all, because there is no offer, no acceptance and no agreement between the parties. It is an obligation which the law itself imposes to prevent one person from being unjustly enriched at the expense of another. Sections 68 to 72 of the Contract Act deal with these relations "resembling those created by contract". If a person supplies necessaries to a minor or a person of unsound mind, he can recover from their property under Section 68. If a trader pays money which another person was bound by law to pay, and in whose payment he was interested, he may recover it under Section 69. Goods delivered by mistake must be returned under Section 72: if a supplier delivers 100 bags of cement to the wrong warehouse and the warehouse owner uses them knowing they were not meant for him, he must pay for them. The basis is equity and natural justice, not consent.

## Contracts According to Validity

### 1. Valid Contracts

A valid contract is an agreement which possesses all the essentials laid down in Section 10 of the Act: free consent of competent parties, lawful consideration, a lawful object, and an agreement not expressly declared void. Such a contract is binding on both sides, and if one party refuses to perform, the court will compel performance or award damages. A contract by which a wholesaler in Faisalabad agrees to supply 500 bales of cloth to a retailer at an agreed price, both parties being adults of sound mind acting freely, is a valid contract in every respect.

## 2. Void Agreements and Void Contracts

Section 2(g) provides that an agreement not enforceable by law is void. Such an agreement is without legal effect from the very beginning; it creates no rights and imposes no duties. Agreements in restraint of marriage (Section 26), agreements in restraint of trade (Section 27), agreements in restraint of legal proceedings (Section 28), wagering agreements (Section 30) and agreements to do impossible acts (Section 56) are all declared void. A distinction must be noted between a void agreement, which is void from the start, and a void contract, which was valid when made but later becomes unenforceable — for example, a contract to import goods from a country with which Pakistan later goes to war, or whose performance becomes impossible when the subject-matter is destroyed.

## 3. Voidable Contracts

Section 2(i) defines a voidable contract as an agreement enforceable by law at the option of one or more of the parties to it, but not at the option of the other or others. Voidable contracts arise where consent was obtained by coercion, undue influence, fraud or misrepresentation (Sections 19 and 19A). The contract remains valid until the injured party decides to set it aside. If an old villager is threatened into selling his land at half its value, he may either enforce the sale or get it cancelled; the choice is his alone. Until he rescinds it, third parties may acquire rights under it, which is why the law expects the injured party to act promptly.

## 4. Illegal and Unenforceable Contracts

An illegal contract is one whose object or consideration is forbidden by law, fraudulent, or opposed to public policy — for example, an agreement to smuggle goods or to commit a crime. Every illegal agreement is void, but every void agreement is not necessarily illegal; a wagering

agreement is void yet not illegal, so money paid under it to a stakeholder raises different questions from money connected with a crime. All the collateral transactions of an illegal agreement are also tainted and void, whereas collateral transactions of a merely void agreement may remain valid. An unenforceable contract, on the other hand, is valid in substance but cannot be sued upon because of some technical defect, such as being oral where the law demands writing, registration or a stamp. Once the defect is removed, it becomes enforceable.

**Table 1: Contracts classified according to validity**

| Type | Meaning | Example |
|---|---|---|
| Valid | Has all essentials of Section 10; binding on both parties | Sale of cloth between two traders at an agreed price |
| Void | No legal effect from the beginning (Section 2(g)) | Agreement in restraint of trade; a wagering agreement |
| Voidable | Enforceable at the option of the injured party (Section 2(i)) | Sale obtained by threats or by fraud |
| Illegal | Object or consideration forbidden by law; also void | Agreement to smuggle goods |
| Unenforceable | Valid in substance but barred by a technical defect | Oral agreement where writing and registration are required |

## Contracts According to Performance

An executed contract is one in which both parties have completely performed their promises, so nothing remains to be done. When a customer pays cash for a bag of rice and the shopkeeper hands it over at once, the contract is executed. An executory contract is one in which performance is still outstanding, wholly or partly: a contract made in October for delivery of sugar in December is executory until delivery and payment are completed. A related

distinction is between bilateral contracts, where promises are exchanged on both sides and both parties are still bound to perform, and unilateral contracts, where one party has already performed and only the other side's promise remains — as when a person advertises a reward of Rs. 10,000 for finding his lost car, and anyone who finds it accepts the offer by the act itself and can claim the reward.

## Contracts According to Form and Some Special Types

According to form, contracts may be simple or formal. In Pakistan most contracts are simple contracts: they may be oral, written or implied, and no particular form is needed. A few transactions must, however, follow a prescribed form — a sale or gift of immovable property, for instance, requires a registered instrument under the Transfer of Property Act, 1882 and the Registration Act, 1908, and a negotiable instrument must be in writing. Among special types recognised by the Contract Act itself, the contingent contract (Sections 31 to 36) deserves mention: it is a contract to do or not to do something if some future uncertain event, collateral to the contract, does or does not happen. Fire and marine insurance policies are the commonest examples — the insurer pays only if the insured event occurs. Contracts of indemnity (Section 124) and of guarantee (Section 126), agency and bailment, which occupy separate chapters of the Act, are also special contracts governed by their own additional rules.

## Conclusion

To conclude, the Contract Act, 1872 supports a rich classification of contracts. By formation they may be express, implied or quasi; by validity they may be valid, void, voidable, illegal or unenforceable; by performance they may be executed or executory, bilateral or unilateral; and by form they may be simple or formal, with special families such as contingent contracts,

indemnity, guarantee, bailment and agency. For a student of mercantile law, and equally for a businessman, the value of this classification is practical: it tells us at a glance whether an arrangement can be enforced in a Pakistani court, who may avoid it, and what will happen if performance fails. Whenever a dispute arises, the first step is always to place the transaction in its correct class, because the rights of the parties follow from that classification.

## Question 2: Offer, Acceptance and Consideration — the Mechanism of Every Contract (20 Marks)

*Every contract involves a mechanism of offer and acceptance in a business, along with consideration.*

### Introduction

The statement given in this question describes the very machinery by which every business contract comes into existence. No contract is born complete; it is built step by step. First, one party makes an offer (also called a proposal). Then the other party accepts that offer. Between the two, supporting the bargain, stands consideration — the price, in money, goods, services or forbearance, which each side gives for the promise of the other. Section 2(a) of the Contract Act, 1872 defines a proposal: 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. Section 2(b) adds 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. Add lawful consideration under Section 2(d), and the promise matures into an agreement, and the agreement, if enforceable by law, into a




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contract. This answer explains each part of the mechanism — offer, acceptance and consideration — together with the rules a businessman in Pakistan must know to use it safely.

## The Offer: Essentials of a Valid Offer

An offer must be made with the intention of creating legal relations. A casual remark at a dinner table, or a social invitation, is not an offer because no legal obligation is intended. The offer must be certain and definite: its terms must be so clear that the other party knows exactly what he is accepting. A vague statement such as "I may sell you my car at a fair price someday" creates nothing. The offer must also be communicated to the offeree (Sections 3 and 4). A person cannot accept an offer he has never heard of; a man who finds a lost dog without knowing of the advertised reward cannot claim it, because there was no communication of the proposal to him. The offer may be general, made to the whole world, as in the famous case of Carlill v. Carbolic Smoke Ball Co. (1893), where a company advertised a reward for anyone who caught influenza after using its smoke ball; Mrs. Carlill used it, caught influenza, and the court held she had accepted a general offer made to the public. In the same way, a Pakistani shopkeeper who advertises a reward accepts a contract with whoever performs the condition.

### Offer Distinguished from an Invitation to Treat

Businessmen must distinguish an offer from a mere invitation to treat (an invitation to make offers). Displaying goods in a shop window with price tags, issuing a price list or catalogue, advertising goods for sale, and calling for tenders are generally invitations, not offers. The customer who picks up goods in a self-service store makes the offer at the cash counter, and the shop accepts it there — the principle of Pharmaceutical Society of Great Britain v. Boots Cash Chemists (1953). In Harvey v. Facey (1893), a telegram stating the lowest price for a

property was held to be only information, not an offer. The practical importance is great: an advertiser is not bound to supply everyone who responds, whereas a person who makes a true offer is bound as soon as it is accepted. An offer may also be subject to conditions, must be distinguished from a mere statement of intention, and comes to an end on lapse of the prescribed or a reasonable time, on rejection, on the death or insanity of the parties before acceptance, or on revocation communicated before acceptance (Sections 5 and 6).

### Acceptance: Rules and Communication

Acceptance is the assent of the offeree to the offer, and it converts the offer into a promise. To be effective, acceptance must be absolute and unqualified (Section 7). It must correspond exactly with the offer; a reply that changes the price, the quantity or any other term is not acceptance but a counter-offer, which destroys the original offer. When Hyde offered to buy a farm for £1,000 and the owner's reply in Hyde v. Wrench (1840) effectively sought £1,000 after first asking more, the court treated the intermediate counter-proposal as having killed the first offer, so it could not later be accepted. Acceptance must also be made in the prescribed manner; if the offer asks for acceptance by telegram or by a stated date, acceptance in another way may not bind the offeror unless he acquiesces. Silence is not acceptance: an offeror cannot write "if I do not hear from you, I shall assume you accept" and thereby bind the offeree, as held in Felthouse v. Bindley (1862).

Communication of acceptance is governed by Sections 3 to 5. As against the proposer, acceptance is complete when it is put into a course of transmission so as to be out of the acceptor's power — this is the postal rule: a letter of acceptance correctly addressed and posted completes the contract even if it is delayed or lost. As against the acceptor, acceptance

is complete when it comes to the knowledge of the proposer. In face-to-face dealing, by telephone or by instant electronic message, acceptance must actually be received and understood, as in Entores Ltd. v. Miles Far East Corporation (1955). Acceptance must also be communicated by the offeree himself or his authorised agent; an unauthorised person's assent is worthless (Powell v. Lee (1908)). Finally, acceptance must be given before the offer lapses or is revoked: a proposer may revoke his offer at any time before acceptance is complete against him, and an acceptor may revoke his acceptance before it comes to the proposer's knowledge (Section 5).

**Table 1: Offer and invitation to treat compared**

| Point | Offer | Invitation to Treat |
|---|---|---|
| Nature | Final willingness to be bound on stated terms | Invitation to others to make offers |
| Effect of response | Acceptance creates a contract at once | Response is itself an offer; no contract yet |
| Examples | Signed quotation agreeing to supply at a fixed price | Shop-window display, catalogue, advertisement, call for tenders |
| Key cases | Carlill v. Carbolic Smoke Ball Co. | Harvey v. Facey; Boots Cash Chemists case |

## Consideration: the Price of the Promise

Even a duly accepted offer fails without consideration. Section 2(d) defines it: 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 to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise. In ordinary language, consideration is something of value given in exchange — money for goods, goods for money, a

service for a fee, or even a promise to give up a legal right. It is, as the English judges said in Currie v. Misa (1875), some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility suffered by the other. The maxim of business life is quid pro quo: something for something. A purely gratuitous promise, such as a promise to gift Rs. 50,000 next month, is generally unenforceable because the promisee gave nothing in return.

The rules about consideration in Pakistan deserve careful attention. First, consideration must move at the desire of the promisor: an act done voluntarily, without his request, is no consideration, though an act done at his desire at an earlier time may be. Secondly, and unusually, Section 2(d) allows consideration to move from the promisee “or any other person”, so a stranger to the consideration may still be a party who can enforce the contract — as in Chinnayya v. Ramayya, where a daughter successfully enforced a promise made to her mother because the consideration, a gift of land, had moved from a third person. This differs from English law. Thirdly, consideration may be past, present or future: a service already rendered at the promisor’s request, a simultaneous exchange, or a promise yet to be performed all qualify. Fourthly, consideration must be real and lawful, not illusory, illegal or impossible, but it need not be adequate: courts will not weigh whether Rs. 100 was a fair price for a watch worth Rs. 10,000 if consent was free, for adequacy is the parties’ own business, though gross inadequacy may be evidence of coercion or fraud. Lastly, Section 25 declares agreements without consideration void, subject to exceptions: a written and registered agreement made out of natural love and affection between near relations, a promise to compensate for something voluntarily done, and a promise to pay a time-barred debt in writing.

## How the Three Elements Work Together in Business

In daily trade the three elements follow one another like links of a chain. A Multan exporter emails a foreign buyer: "We offer 1,000 bags of rice at $420 per tonne, shipment in November, offer open for seven days." That is the offer — definite, communicated, time-bound. The buyer replies within the week: "Accepted at $420 per tonne." That unqualified assent is acceptance, and the moment it is communicated the promise exists. Consideration supports both promises: the rice and the shipping effort on one side, the price on the other. Break any link and the chain fails: if the buyer replies "accepted if you reduce to $400" there is only a counter-offer; if the exporter promises the rice as a free gift there is no consideration; if the reply arrives after the seventh day the offer has lapsed. Mastery of this mechanism lets a businessman know exactly when he becomes bound, when he may still withdraw, and when he may hold the other side to its bargain.

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## Conclusion

To conclude, the statement in the question is an accurate summary of contract formation. Offer supplies the starting point, acceptance supplies the agreement of minds, and consideration supplies the legal value that makes the agreement enforceable. The Contract Act, 1872 regulates each stage in Sections 2 to 10 and in the communication and revocation rules of Sections 3 to 6. A student who understands what makes an offer valid, how acceptance must be absolute and communicated, and why consideration must be present, real and lawful, understands how every business contract — from a bus ticket to a multi-million-rupee supply agreement — is created.

## Question 3: Free Consent and Its Legal Provisions (20 Marks)

*What is meant by the term free consent? Explain the various legal provisions regarding free consent in a contract.*

### Introduction

A contract is supposed to be the meeting of two free minds. If a person signs an agreement because he was threatened, deceived or unfairly dominated, the law cannot treat his promise in the same way as the promise of a person who bargained freely. That is why Section 10 of the Contract Act, 1872 makes free consent one of the essentials of a valid contract, and Section 13 defines consent itself: two or more persons are said to consent when they agree upon the same thing in the same sense -- the Roman idea of consensus ad idem. Section 14 then explains when consent is "free": consent is said to be free when it is not caused by coercion (Section 15), undue influence (Section 16), fraud (Section 17), misrepresentation (Section 18), or mistake (Section 20), subject to the rules about mistake in Sections 20 to 22. Where any of these five factors vitiates consent, the Act prescribes consequences — in most cases the contract becomes voidable at the option of the injured party, and in the case of a fundamental bilateral mistake it is void altogether. This answer explains each vitiating factor, its legal provisions and its effects, with examples.

### Coercion — Section 15

Coercion is the committing, or threatening to commit, any act forbidden by the Pakistan 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. Three features deserve notice. First, the threat may be directed not only against the contracting party

but against any person, including his family. Secondly, the property detained need not belong to the party coerced; detaining a third person's goods to force a bargain can amount to coercion. Thirdly, it is immaterial whether the Penal Code is or is not in force at the place where the coercion occurs, a point the Act explains by the illustration of an act done on the high seas. A threat to commit suicide has been treated by the courts of the subcontinent as coercion, because suicide is an offence under the Penal Code. Under Section 19, an agreement whose consent was caused by coercion is voidable at the option of the party whose consent was so caused, and money paid or goods delivered under it must be restored. In practice, if a moneylender threatens to burn a farmer's crops unless he signs a loan bond at an extortionate rate, the farmer may, on proof of the threat, get the bond set aside.

### Undue Influence — Section 16

Undue influence is subtler than coercion: no threat is made, but one party is in a position to dominate the will of the other and uses that position to obtain an unfair advantage. Section 16(2) lists situations where domination is presumed: where one party holds real or apparent authority over the other, or stands in a fiduciary relation to him — parent and child, guardian and ward, doctor and patient, spiritual adviser and disciple, trustee and beneficiary — and where a contract is made with a person whose mental capacity is temporarily or permanently affected by age, illness or mental or bodily distress. If the transaction appears, on the face of it or on the evidence, to be unconscionable, Section 16(3) shifts the burden of proof: the dominant party must prove that no undue influence was used. Under Section 19A the court may set aside a contract induced by undue influence absolutely, or, if the victim has received a benefit, upon such terms as the court thinks just. The classic illustration is of an illiterate elderly




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woman who gifts away her entire property to her spiritual adviser; equity intervenes because consent in form was not consent in reality.

## Fraud — Section 17

Fraud means an act committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party or to induce him to enter into the contract. Section 17 enumerates five forms: (1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true — suggestio falsi; (2) the active concealment of a fact by one having knowledge or belief of it; (3) a promise made without any intention of performing it; (4) any other act fitted to deceive; and (5) any act or omission which the law specially declares to be fraudulent. Mere silence is not fraud, but the Explanation to Section 17 creates two exceptions: silence is fraudulent where the circumstances impose a duty to speak (as in contracts of utmost good faith, like insurance), or where silence itself is equivalent to speech — a seller who stays silent when the buyer says "I will pay a high price if the horse is sound", knowing the horse is unsound, commits fraud. Under Section 19 a contract induced by fraud is voidable at the option of the deceived party, who may instead insist on performance and be put in the position he would have occupied had the representation been true; he may also claim damages. If a dealer knowingly sells a car with a tampered meter showing 30,000 km instead of 130,000 km, the buyer may rescind the sale or keep the car and recover compensation.

## Misrepresentation — Section 18

Misrepresentation is a false statement made innocently, without intent to deceive. Section 18 covers three situations: the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true; any breach of duty which, without an intent to

deceive, gains an advantage to the person committing it by misleading another to his prejudice; and causing, however innocently, a party to make a mistake as to the substance of the thing which is the subject of the agreement. A house owner who honestly but wrongly states, on the basis of an outdated survey, that his plot measures ten marlas when it measures eight, misrepresents; he did not intend to cheat, yet the buyer was misled. The remedy under Section 19 is again voidability at the option of the misled party, together with the right to insist that he be placed in the position he would have occupied had the statement been true. Unlike fraud, however, misrepresentation by itself does not give an independent claim for damages, and Section 19 adds an important exception: if the party misled had the means of discovering the truth with ordinary diligence, the contract is not voidable for misrepresentation or for fraud by silence.

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**Table 1: Factors vitiating free consent and their effects**

| Factor | Section | Essence | Effect on Contract |
|---|---|---|---|
| Coercion | 15 | Threat of an act forbidden by the Penal Code, or unlawful detention of property | Voidable at victim's option (Section 19) |
| Undue influence | 16 | Domination of will in a position of trust; unfair advantage | Court may set aside absolutely or on terms (Section 19A) |
| Fraud | 17 | Intentional deception in five listed forms; silence only exceptionally | Voidable; damages may also be claimed (Section 19) |
| Misrepresentation | 18 | False statement made innocently | Voidable, subject to ordinary-diligence exception (Section 19) |
| Mistake | 20–22 | Both parties mistaken | Bilateral mistake: void; |

| | | | |
|---|---|---|---|
| | | about an essential fact (bilateral) or similar errors | unilateral mistake: generally valid (Section 22) |

## Mistake — Sections 20 to 22

Mistake differs from the other four factors because nobody is at fault: the parties simply proceed on a wrong assumption. Where both parties are under a mistake as to a matter of fact essential to the agreement, Section 20 declares the agreement void — for instance, a contract to buy a specific horse which, unknown to both, had died the previous day, or to buy a cargo which had already perished at sea. An erroneous opinion about the value of the thing contracted for is expressly not a mistake of fact. Section 21 deals with mistake of law: a contract is not voidable because it was caused by a mistake as to any law in force in Pakistan, for everyone is presumed to know the law of his own country; but a mistake as to a law not in force in Pakistan has the same effect as a mistake of fact. Section 22 covers unilateral mistake: a contract is not voidable merely because it was caused by one party's mistake of fact, such as a bidder misreading his own figures. The courts nevertheless refuse enforcement where the mistake goes to the very identity of the other party or the nature of the document signed, for there consent in the Section 13 sense is altogether absent.

## Conclusion

To conclude, free consent under Sections 13 and 14 of the Contract Act, 1872 is consent given without coercion, undue influence, fraud, misrepresentation or mistake. The Act deals with each factor in its own section and grades the consequences: fraud, coercion and misrepresentation make the contract voidable at the injured party's option under Section 19,

undue influence empowers the court to set the bargain aside on just terms under Section 19A, while a bilateral mistake on an essential fact makes the agreement void from the start under Section 20. The scheme reflects a balanced business morality: genuine bargains are upheld, but no one may hold another to a promise that was never truly free.

## Question 4: Novation, Revocation and Performance of a Contract (20 Marks)

*What is meant by novation and revocation in a contract? Also, explain in detail with examples the legal provisions regarding the performance of the contract.*

### Introduction

A contract does not live only at the moment of its formation. During its life the parties may replace it with a new bargain, proposals leading to it may be withdrawn at the proper stage, and, most importantly, the promises it contains must actually be performed. The Contract Act, 1872 deals with these matters in Sections 5 and 6 (revocation of proposals and acceptances), Sections 37 to 56 (performance of contracts) and Section 62 (novation, rescission and alteration). Novation and revocation concern change and withdrawal; performance concerns fulfilment. Together they answer three practical business questions: can we substitute a fresh arrangement for the old one, can a party still withdraw, and how exactly must the agreed work be done, by whom, when and where? This answer takes each topic in turn and illustrates it with examples.

### Novation — Section 62

Novation means the substitution of a new contract for an existing one, with the consent of all parties concerned, whereupon the old contract is extinguished and need not be performed.

Section 62 provides: if the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed. Novation may take two forms. In the first, the terms of the contract are changed but the parties remain the same: a debtor who owes Rs. 500,000 payable in June agrees with his creditor to pay instead in December with additional interest, and the old obligation is replaced by the new one. In the second form, a new party is substituted: A owes B Rs. 200,000, and all three agree that C shall take A's place as debtor, so B must now look to C alone. The essentials of a valid novation are that there must be a valid old contract, the consent of every party including the incoming party, and a valid new contract which completely extinguishes the old; if the new contract is itself unenforceable, the old contract revives. Novation must be distinguished from alteration, where only a term is varied by consent while the contract otherwise continues, and from rescission, where the parties simply cancel the contract without substituting anything. A common commercial example is the restructuring of a bank loan, where the original loan agreement is replaced by a rescheduled agreement on new rates and dates with the bank's consent — after novation, the borrower's duties are measured by the new deed alone.

## Revocation in a Contract

Revocation means withdrawal or cancellation. In the law of contract the term is chiefly used for the revocation of a proposal and of an acceptance before the contract is concluded, governed by Sections 5 and 6. A proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards (Section 5). If a trader in Rawalpindi offers to sell his shop for Rs. 8 million and, before the buyer's acceptance letter is posted, telephones to withdraw the offer and the buyer learns of the withdrawal first, no




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contract can arise. An acceptance may likewise be revoked at any time before its communication is complete as against the acceptor — for instance, by a faster telegram overtaking a posted letter of acceptance. Section 6 lists the modes by which a proposal is revoked: by communication of notice of revocation; by lapse of the time prescribed for acceptance or of a reasonable time; by the failure of the acceptor to fulfil a condition precedent; and by the death or insanity of the proposer, if knowledge of it reaches the acceptor before acceptance. Once a contract has actually been formed, it cannot be revoked unilaterally at all: it can only be discharged by performance, by agreement (including novation and rescission under Section 62), by impossibility under Section 56, or by breach — and a party who wrongfully "revokes" a concluded contract in fact commits a breach and must pay damages under Section 73. The word is also used for the revocation of a continuing guarantee (Section 130) and of an agent's authority (Section 201 onwards), in each case meaning that future liability or power is terminated while accrued rights survive.

## Performance of a Contract: the General Obligation

Section 37 lays down the foundation: the parties to a contract must either perform, or offer to perform, their respective promises, unless performance is dispensed with or excused under the Act or any other law. An offer to perform, called a tender, must be unconditional, made at the proper time and place, and must give the promisee a reasonable opportunity of inspection where goods are concerned; a valid tender refused by the promisee has the same effect as performance. Promises bind the representatives of the promisors in case of their death before performance, unless a contrary intention appears or the promise involves personal skill — a painter's promise to paint a portrait dies with him, but a promise to pay money binds his estate.

Performance must be exact and complete: a promisor who delivers 950 bags against a contract for 1,000 has not performed, and the promisee may reject the whole, though if he accepts part delivery he must pay for what he keeps at the contract rate.

## Who Must Perform — Sections 40 to 45

Section 40 states the rule for personal performance: if it appears from the nature of the case that the parties intended a promise to be performed by the promisor himself — a singer engaged to sing, an architect engaged for his personal design — he must perform it personally. In other matters the promisor, or his representative, may employ a competent person to perform, as a builder may engage masons to execute a construction contract. Under Section 41, if the promisee accepts performance from a third party he cannot afterwards enforce it against the promisor. Sections 42 to 45 govern joint promisors: unless a contrary intention appears, joint promisors must perform jointly; on the death of one, his representative is liable jointly with the survivors; the promisee may compel any one of the joint promisors to perform the whole promise, and a promisor so compelled may claim contribution from the others (Sections 43 and 44); if the promisee releases one joint promisor, the others are not discharged, nor is the released promisor freed from his duty to contribute. For example, if three partners jointly promise to repay a bank loan of Rs. 900,000, the bank may recover the entire sum from any one of them, leaving him to claim Rs. 300,000 each from the other two.

## Time, Place and Manner of Performance — Sections 46 to 50

Where no time is fixed and the promise is not to be performed without application by the promisee, Section 46 requires performance within a reasonable time, judged by the facts of each case. Where a day is fixed and performance is due without application, Section 47 requires

the promisor to perform on that day during usual business hours at the place where the promise ought to be performed; the illustration is of a payment for goods to be made on a stated day at the buyer's warehouse. Where the promise is to be performed on application, Section 48 obliges the promisee to apply at a proper place and within business hours. If no place is fixed, Section 49 makes it the promisor's duty to seek out the promisee and ask him to appoint a reasonable place — in money debts this survives in the maxim that the debtor must seek his creditor. Section 50 allows performance in any manner, or at any time, which the promisee prescribes or sanctions. Where time is of the essence of the contract, as in most mercantile contracts for delivery by a shipment date, failure to perform by the fixed day makes the contract voidable at the promisee's option (Section 55); where time is not essential, late performance gives rise only to compensation.

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### Appropriation of Payments and Reciprocal Promises

Sections 59 to 61 settle which debt a payment discharges when a debtor owes several. First the debtor may appropriate the payment to a particular debt; failing that, the creditor may appropriate it to any lawful debt, even a time-barred one; failing both, the law appropriates it in order of time, earliest debt first. Reciprocal promises — promises forming consideration for each other — are regulated by Sections 51 to 58: they must be performed simultaneously where that is the intention (Section 51), in the order expressly fixed or required by their nature (Section 52), and a party who prevents the other from performing cannot complain of non-performance and must compensate him (Section 53). A promise to do something illegal in part cannot be enforced in its legal part if the two cannot be separated (Sections 57 and 58 treat alternative and partly illegal promises). Finally, Section 56 discharges a contract whose

performance becomes impossible or unlawful after it is made — an agreement to sell a specific cargo is discharged if the cargo perishes, and a music hall hired for concerts was held discharged in Taylor v. Caldwell (1863) when the hall burnt down before the first concert.

### Conclusion

To conclude, novation (Section 62) lets the parties, by common consent, extinguish an old contract and substitute a new one; revocation (Sections 5 and 6) lets a proposal or an acceptance be withdrawn, but only before it crystallises into a concluded contract; and performance (Sections 37 to 56) is the normal, expected end of every contract, with detailed rules about who must perform, joint liability, time and place, appropriation of payments and reciprocal promises. A businessman who knows these provisions knows both how to change a bargain lawfully and how strictly the law expects bargains to be kept.

## Question 5: Contract of Guarantee and Warranty under the Contract Act, 1872 (20 Marks)

*What is a contract of guarantee & warranty under the Contract Act 1872? Explain with examples.*

### Introduction

Business credit rests on trust, and trust is often reinforced by the promise of a third person. A bank lends to a young trader because his established uncle stands behind him; a supplier delivers goods on credit because a reputable firm vouches for the buyer. That supporting promise is the contract of guarantee, regulated by Sections 124 to 147 of the Contract Act, 1872, in the same chapter that deals with indemnity. Closely allied in mercantile practice is the warranty: a collateral promise or assurance about the quality or condition of what is supplied,

breach of which gives rise to a claim for damages but does not, by itself, entitle the buyer to throw up the whole transaction. This answer first explains the contract of guarantee in full — its meaning, parties, essentials, the extent and discharge of the surety's liability and the surety's rights — and then explains warranty as used in mercantile law, contrasting the two and illustrating both with examples.

## Contract of Guarantee — Section 126

Section 126 defines a contract of guarantee as a contract to perform the promise, or discharge the liability, of a third person in case of his default. Three parties are therefore always involved: the surety, who gives the guarantee; the principal debtor, in respect of whose default the guarantee is given; and the creditor, to whom the guarantee is given. Section 127 adds that anything done or any promise made for the benefit of the principal debtor may be sufficient consideration for the surety — the surety needs no direct benefit himself. A guarantee may be oral or written, though in banking practice it is always written, usually in a stamped guarantee deed. It must also be distinguished from a contract of indemnity (Section 124), which has only two parties and in which the promisor promises to save the other from loss caused by his own conduct or by the conduct of any other person. The classic example of a guarantee: Aslam asks Bank Alfalah to lend Rs. 2,000,000 to his nephew Bilal for a hosiery business, and promises the bank, "If Bilal fails to repay, I will pay." The bank is the creditor, Bilal the principal debtor and Aslam the surety. Fidelity guarantees are equally common: an employer takes a guarantee from a surety for the honesty of a cashier, so that if the cashier misappropriates funds the surety must make good the loss.

## Essentials and Kinds of Guarantee

The essentials of a valid guarantee are: (1) a principal debt or duty owed by the principal debtor to the creditor, actual or prospective; (2) a promise by the surety to answer for that debt on default, which must satisfy the general essentials of a contract, including free consent — a guarantee obtained by the creditor's misrepresentation (Section 142) or concealment (Section 143) of material facts is invalid; (3) consideration, which, as noted, may consist of the benefit to the principal debtor under Section 127; and (4) no requirement of writing under the Act itself. Guarantees are of two main kinds. A specific guarantee covers a single debt or transaction and ends when that debt is repaid. A continuing guarantee (Section 129) extends to a series of transactions — for example, a guarantee up to Rs. 500,000 for goods supplied from time to time to a retailer — and it may be revoked by the surety, as to future transactions, by notice to the creditor (Section 130), or it is revoked by the surety's death as regards future transactions once the creditor learns of the death (Section 131).

## Liability of the Surety and His Discharge

Section 128 lays down that the liability of the surety is co-extensive with that of the principal debtor, unless otherwise provided by the contract. The creditor may proceed directly against the surety without first suing the principal debtor or exhausting remedies against him; the surety's liability arises the moment default occurs. Yet the law protects the surety in several ways. He is discharged if the creditor and the principal debtor, without his consent, vary the terms of the original contract (Section 133), release the principal debtor or compound with him (Section 134), or give him time under a binding agreement (Section 135). Any act of the creditor inconsistent with the surety's rights, or omission which impairs the surety's eventual remedy

against the principal debtor, also discharges him (Section 139). On the other hand, mere forbearance to sue the principal debtor does not discharge the surety (Section 137), and the release of one co-surety does not discharge the others (Section 138). Where there are co-sureties, they are liable to contribute equally, subject to any agreed limits (Sections 146 and 147).

### Rights of the Surety

The surety is not left without protection. On paying the debt he is invested with all the rights the creditor had against the principal debtor — the right of subrogation under Section 140 — so he steps into the creditor's shoes and may recover from the debtor, and he is entitled to the benefit of every security the creditor held (Section 141), even if he did not know of it. Section 145 implies a promise by the principal debtor to indemnify the surety for whatever sum he has rightfully paid under the guarantee, though not for sums paid wrongfully. A practical example completes the picture: if surety Aslam pays the bank Rs. 2,000,000 on Bilal's default, Aslam may immediately sue Bilal for the whole amount, enforce any mortgage Bilal had given the bank, and claim interest and costs he rightfully incurred.

## Warranty in Mercantile Law

A warranty is a promise or assurance which is collateral to the main purpose of a contract. In the law of sale of goods, from which the term draws its precise legal meaning in mercantile usage, Section 12 of the Sale of Goods Act, 1930 — a statute read together with the Contract Act in every mercantile law course — distinguishes a condition, which is a stipulation essential to the main purpose of the contract, from a warranty, which is a stipulation collateral to that main purpose. Breach of a condition entitles the buyer to treat the contract as repudiated and




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reject the goods; breach of a warranty entitles him only to damages, or to set up the breach in diminution of the price (Sections 12 and 13 of that Act), while the goods must be kept. Suppose a buyer orders a generator of a stated power for his factory and it is delivered with a defect in a minor accessory, contrary to the seller's assurance that it was complete: if the assurance goes to the root of the bargain it is a condition, but if it is subsidiary it is a warranty, and the buyer's remedy is compensation for the loss, not rejection. The same idea appears throughout commerce: a manufacturer's written warranty on a refrigerator or a motor car promises repair or replacement of defects for a stated period, and a warranty in a proposal for insurance requires the statements made to be exactly true.

Read in the context of the Contract Act, therefore, the question's two expressions cover the two supporting promises of mercantile life. A guarantee supports the person: a third party binds himself to answer for another's default. A warranty supports the thing or the statement: the promisor binds himself that a fact is or shall be as stated, and pays damages if it is not. They differ in structure — a guarantee needs three parties and a principal debtor, a warranty needs only the parties to the main contract; they differ in remedy — on default under a guarantee the whole debt becomes payable by the surety, whereas breach of warranty sounds only in damages and never, by itself, in rejection of the contract; and they differ in discharge — a surety is freed by the creditor's unauthorised dealings with the debtor, while a warrantor remains liable for his broken assurance for the agreed period. An example combining both: a dealer sells a tractor, guaranteeing through the buyer's father that the instalments will be paid, and warranting that the engine is free from defect for two years. If the buyer defaults, the




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father pays as surety; if the engine fails, the dealer repairs it or pays damages under the warranty, but the sale itself stands.

## Conclusion

To conclude, the contract of guarantee under Sections 126 to 147 of the Contract Act, 1872 is a three-party contract by which a surety promises a creditor to discharge a principal debtor's liability on default; the surety's liability is co-extensive with the debtor's, he may be discharged by variations and dealings to which he never consented, and on payment he gains the rights of subrogation, security and indemnity. A warranty, by contrast, is a collateral assurance — most precisely defined in the companion Sale of Goods Act — whose breach yields damages without undoing the main bargain. Both devices reduce risk and make credit and trade possible, which is why they occupy a permanent place in mercantile law.

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