



Understanding the Concept of Consideration and Privity of Contract Under Indian Contract Act

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ABSTRACT

This article provides a comprehensive overview of Section 25 of the Indian Contract Act, 1872, which delineates exceptions to the general rule that agreements made without consideration are void. Section 25 outlines specific circumstances under which agreements lacking traditional consideration are still deemed valid and enforceable. Further, it provides an in-depth exploration of the concept of privity of contract, elucidating its fundamental principles, applications, and exceptions. Through a comprehensive analysis, it navigates the intricate landscape of privity of contract, highlighting its significance in defining the rights and obligations of parties to a contract. Additionally, the abstract examines landmark legal precedents and legislative provisions that have shaped the development and interpretation of privity of contract and consideration in various jurisdictions. Furthermore, it discusses the practical implications of privity in contractual disputes, emphasizing its role in safeguarding contractual autonomy and promoting fairness and equity.

INTRODUCTION

The Indian Contract Act, 1872 governs the law of contracts in India.¹ Consideration and Privity of contract are two foundational concepts under the law of contract. Consideration is an essential element of a valid contract under common law jurisdictions, including India. It is something of value exchanged between the parties to a contract, which induces them to enter into the agreement and forms the basis of their mutual promises. The presence of consideration in a contract distinguishes it from mere gratuitous promise or gift. It reflects the parties' intention to create legal obligations and bind themselves to the terms of the agreement. The presence of consideration distinguishes a contract from a mere gratuitous promise or gift, as it reflects the parties' intention to create legal obligations and bind themselves to the terms of the agreement. In other words, a third party who is not a party to the contract generally cannot assert rights or obligations arising from that contract, nor can they be held liable for its breach unless it is provided by the Indian Contract Act.

1. CONSIDERATION

Consideration is one of the essential elements of a valid contract under Indian Contract Act. Consideration is defined in Section 2(d) of the Act as:

*"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."*²

In simpler terms, consideration is something of value given or promised in exchange for something else.

Section 2(h) defines the term contract: "An agreement enforceable by law is a Contract".

Section 10 of the contract act provides that the Agreement made by Competent Parties, out of their free consent and with lawful consideration are contract.

1.1 Lawful Consideration:

The Indian contract act under section 23 and 24 discusses that the object of the contract and consideration for which it is entered must be lawful. Section 23 prohibits the consideration and objects that are unlawful, immoral and fraudulent. It states that consideration and object are lawful unless it is-

- a. Forbidden by Law:

¹ <https://www.centurylawfirm.in/blog/the-indian-contract-act-1872-types-of-contracts-validity-and-drafting>

² <https://www.drishtijudiciary.com/to-the-point/tp-indian-contract-act/consideration>

Any agreement that contravenes a specific statutory provision or is explicitly prohibited by legislation is void.

b. **Defeating the Provisions of Any Law:**

Even if an agreement's consideration or object is not explicitly forbidden by law, it is still void if allowing it would defeat the provisions of any existing law. In other words, if the agreement undermines the purpose or intent of a law, it cannot be enforced.

c. **Fraudulent:**

Agreements that are entered into with fraudulent intent are void. If the purpose of the agreement is to deceive or defraud someone, it is considered unlawful and unenforceable.

d. **Involves or Implies Injury to Person or Property:**³

Agreements that involve or imply injury to the person or property of another are void. This includes agreements that promote or encourage harm, violence, or damage to individuals or their belongings.

e. **Immoral or Opposed to Public Policy:**

This part of Section 23 prohibits agreements that the court deems immoral or contrary to public policy. Public policy encompasses principles and values that are considered fundamental to society's welfare and well-being. Agreements that undermine these principles or are deemed socially harmful or detrimental are void.

Section 24 of Contract Act deals with agreements that are void due to uncertainty. It stipulates that agreements with uncertain elements are considered void.

1.2 Agreement without Consideration

Section 25 of the Indian Contract Act, 1872, deals with agreements made without consideration.⁴ It states that Agreements without consideration are void, unless it comes within certain exceptions.

Exceptions to the Rule:

i. **Natural Love and Affection (Section 25):**

A contract made out of natural love and affection between parties is valid, even if there is no monetary consideration involved. For example, a gift made between family members out of affection and without any expectation of monetary gain would be valid under this exception.

ii. **Promise to Compensate Past Voluntary Services (Section 25):**

A promise to compensate someone for services already rendered voluntarily is enforceable, even without fresh consideration. For instance, if A voluntarily helps B repair their house, and later B promises to pay A for their assistance, this promise is binding even though A did not expect payment at the time they provided the help.

iii. **Completed Gifts (Section 122):**

A completed gift, where the donor has voluntarily transferred ownership of property to the donee without any expectation of receiving anything in return, does not require consideration. Once the gift is delivered and accepted, the transfer of ownership is considered complete, and the gift is irrevocable.

iv. **Agency (Section 185):**

Contracts made through an agent on behalf of a principal can be binding on the principal, even if the agent does not receive any consideration. The principal is bound by the contract made by the agent within the scope of their authority, regardless of whether the agent receives consideration.

v. **Beneficiary of Trust (Section 2(d)):**

As mentioned earlier, a beneficiary of a trust may enforce rights under a contract made for their benefit, even if they are not parties to the contract themselves. This does not necessarily require consideration from the beneficiary.

vi. **Time-Bound Charitable Subscriptions (Section 25):**

Charitable subscriptions made by a person, either as a donation or promise to donate, are enforceable if made with a specific time limit and for a charitable purpose, even without consideration.

These exceptions allow for certain contracts to be enforceable without the traditional requirement of consideration, promoting flexibility and fairness in contractual arrangements within the framework of the Indian Contract Act, 1872.

³ <https://www.collegesidekick.com/study-docs/4881305>

⁴ <https://thelawgist.org/agreement-without-consideration-is-void-section-25>

2. PRIVACY OF CONTRACT

The concept of privity of contract is an important aspect of contract law, governing the relationship between parties to a contract and the enforceability of contractual rights and obligations. The doctrine of privity of contract essentially means that only parties to a contract have rights or obligations under that contract. This doctrine is primarily enshrined in Section 2(d) and Section 2(h) of the Indian Contract Act, 1872.

a. Definition and Explanation:

Privity of contract refers to the legal relationship that exists exclusively between the parties who have entered into a contract. It signifies that only those parties who are privy to the contract have rights to enforce its terms or obligations. Under this doctrine, a third party who is not a party to the contract generally cannot enforce any rights or obligations arising from that contract, nor can they be bound by its terms.

b. Section 2(d) of the Indian Contract Act, 1872:

This section defines consideration, which is an essential element of a valid contract, as discussed above. While it doesn't explicitly mention privity of contract, the concept of consideration is closely tied to the idea of parties to a contract.

c. Section 2(h) of the Indian Contract Act, 1872:

This section defines a contract as an agreement enforceable by law. Again, while not explicitly mentioning privity, it underscores the principle that contracts create legal obligations only between the parties to the agreement.

2.2 The essentials of Privity of contract-

- a. **Direct Relationship:** Privity of contract establishes that contractual rights and obligations exist only between the parties who have directly entered into the contract. This means that only the parties to the contract have legal standing to enforce its terms or be bound by its provisions.
- b. **Third-Party Exclusion:** Generally, a third party who is not a party to the contract cannot enforce any rights or obligations under that contract. This principle prevents outsiders from interfering in the contractual relationship between the contracting parties.
- c. **Enforcement Restrictions:** Because of the privity rule, a third party cannot sue to enforce the terms of a contract, even if the contract was made for their benefit or if they would be adversely affected by its breach. Similarly, a third party cannot be held liable for breach of contract unless they are a party to the agreement.
- d. **Autonomy of Contracting Parties:** Privity of contract upholds the autonomy of the parties to a contract by ensuring that they have control over the terms of their agreement and are not unduly influenced or burdened by obligations to third parties.

2.3 Exceptions to the doctrine of privity of contract in India:

i. Beneficiary of Trust:

If a contract is made for the benefit of a third-party beneficiary, that beneficiary can enforce the contract's terms, even though they are not a party to the contract. This exception typically arises in cases where a trust is created for the benefit of a specific individual or group of individuals. In such cases, the beneficiaries of the trust can enforce the terms of any contracts made for their benefit.

ii. Covenants Running with Land:

In certain situations involving real property, covenants (agreements) may "run with the land," meaning they bind subsequent owners of the property, even if those owners were not parties to the original contract. For example, if a developer sells plots of land with certain restrictive covenants regarding land use, subsequent purchasers of those plots may be bound by those restrictions, even though they were not parties to the original contract.

iii. Agency:

When a contract is entered into through an agent acting on behalf of a principal, both the principal and the third party may have rights and obligations under the contract. This exception allows a third party to enforce rights against the principal or be bound by obligations owed to the principal, even though the third party did not directly contract with the principal.

iv. Assignment of Contractual Rights:

A party to a contract may assign its rights under the contract to a third party. In such cases, the third party (assignee) can enforce those rights against the other party to the original contract. However, the assignment must be valid and may be subject to any restrictions or requirements specified in the original contract or under applicable law.

v. Statutory Exceptions:

Certain statutes or laws may provide for exceptions to the doctrine of privity of contract in specific contexts. For example, consumer protection laws may grant certain rights to consumers who were not parties to the original contract but are affected by its terms. Similarly, insurance laws may allow beneficiaries to enforce insurance contracts even though they were not direct parties to the contract.

vi. **Family Arrangements:**

In some cases involving family arrangements or settlements, courts may recognize rights or obligations even though the parties to the arrangement were not direct parties to the original contract.

These exceptions demonstrate that while privity of contract is a fundamental principle in Indian contract law, there are situations where third parties may have rights or obligations arising from a contract, either by statute or by common law principles.

2.3 Case laws relating to Exception to Privity of Contract-

There have been several landmark cases in Indian contract law that have addressed and established exceptions to the doctrine of privity of contract.

1) **Tweddle v. Atkinson (1861):**

This English case was influential in shaping the doctrine of privity of contract in India and other common law jurisdictions. Although it is not an Indian case, its principles have been adopted in Indian contract law.

Facts: The father of the groom and the father of the bride entered into a contract whereby they agreed to pay the groom a certain sum of money. However, only the father of the groom signed the contract, and the father of the bride did not.

Judgment: The court held that since the father of the bride did not personally sign the contract, he could not be sued for breach of contract, despite being a beneficiary. This case reinforced the principle of privity of contract but also highlighted the need for exceptions to protect intended beneficiaries.

2) **Shankarlal v. Jagannath⁵:**

This Indian case addressed the exception of beneficiary under trust.

Facts: A contract was entered into for the sale of certain properties. The seller was required to clear certain encumbrances on the properties. The purchaser transferred the purchase amount to a trustee, who was to hold it until the encumbrances were cleared.

Judgment: The Supreme Court of India held that the contract was made for the benefit of the purchaser, and the trustee was holding the purchase amount in trust for the purchaser. Thus, the purchaser was entitled to enforce the contract against the seller and compel the trustee to release the purchase amount.

3) **Govindlal v. Parashram⁶:**

This case addressed the exception of covenants running with the land.

Facts: A lease agreement contained a clause restricting the lessee from subletting the property without the lessor's consent. The lessee subsequently sublet the property without obtaining consent.

Judgment: The Supreme Court of India held that the covenant restricting subletting was a restrictive covenant running with the land. Thus, subsequent lessees were bound by the covenant, even though they were not parties to the original lease agreement.

4) **Jainuddin v. Moulia⁷:**

This case addressed the exception of family arrangements.

Facts: Family members entered into an oral family settlement agreement to divide family properties. Subsequently, one of the family members challenged the agreement, claiming that she was not a party to it.

Judgment: The Supreme Court of India held that family arrangements, even if oral, are enforceable if they are fair, equitable, and intended to resolve family disputes. Thus, the agreement was upheld, and the challenging family member was bound by its terms.

These cases illustrate how Indian courts have recognized and applied exceptions to the doctrine of privity of contract to ensure fairness and equity in contractual relationships, especially when third parties are affected by the contract's terms.

2.4 How it is different from England-

The doctrine of privity of contract, while fundamental to both Indian and English contract law, exhibits some differences in application and interpretation between the two jurisdictions.

⁵ AIR 1962 SC 833

⁶ AIR 1965 SC 1723

⁷ AIR 2003 SC 3507

Statutory Provisions:

In India, the doctrine of privity of contract is largely based on judicial interpretation and common law principles. While the Indian Contract Act, 1872, contains provisions relevant to contracts, it does not expressly codify the doctrine of privity of contract.

In contrast, English contract law has developed both through judicial decisions and statutory provisions. The Contracts (Rights of Third Parties) Act 1999 introduced significant changes to the doctrine of privity in England by allowing certain third parties to enforce contractual rights, thereby departing from the traditional common law rule.

Third Party Rights:

Historically, Indian contract law has adhered more strictly to the doctrine of privity, limiting the enforcement of contractual rights to the parties who are directly involved in the contract. Third parties generally cannot enforce contractual rights unless they fall within specific exceptions recognized by courts.

In England, the Contracts (Rights of Third Parties) Act 1999 allows third-party beneficiaries to enforce contractual terms in certain circumstances, even if they are not parties to the contract. This statutory intervention significantly departs from the traditional privity rule and provides greater flexibility for third-party enforcement of contract rights.

Exceptions and Modifications:

While both Indian and English contract law recognize exceptions and modifications to the doctrine of privity, the scope and application of these exceptions may vary between the two jurisdictions.

In India, exceptions to privity include contracts made through agents, assignments of contractual rights, trusts, and contracts made for the benefit of third-party beneficiaries, among others. However, these exceptions are primarily based on judicial decisions and principles of equity.

In England, the Contracts (Rights of Third Parties) Act 1999 introduces a statutory framework for third-party rights, which allows certain third parties to enforce contractual terms directly, irrespective of common law privity restrictions.

CONCLUSION

The principles of consideration and privity of contract constitute the bedrock of contract law, shaping the nature and scope of contractual relationships in both commercial and personal spheres. Consideration, as the cornerstone of contract formation, underscores the mutuality of obligations and signifies the parties' intent to create legal relations. It ensures that contracts are entered into with seriousness and reciprocity, thereby fostering trust, predictability, and enforceability in commercial dealings. Additionally, consideration serves as evidence of the parties' consent and provides a basis for the enforcement of contractual rights and remedies.

Similarly, privity of contract establishes the boundaries of contractual relationships by confining rights and obligations exclusively to the parties who have entered into the agreement. This principle safeguards the autonomy of contracting parties and prevents unauthorized interference by third parties. While privity of contract generally prohibits third-party enforcement of contractual rights, certain exceptions and modifications recognize the interests of beneficiaries, assignees, and other third parties under specific circumstances.

Together, consideration and privity of contract contribute to the stability, fairness, and efficacy of contractual arrangements, ensuring that agreements are entered into voluntarily, with clear terms, and with due regard for the rights and obligations of all parties involved. By upholding these principles, contract law facilitates economic transactions, promotes commercial certainty, and maintains the integrity of contractual relationships in a diverse and evolving legal landscape. As foundational concepts in contract law, consideration and privity continue to shape the contours of contractual obligations, providing a framework for equitable and enforceable agreements in the pursuit of legal justice and commercial efficacy.

Bibliography

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