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Decoding the moment of contract formation: the juggle between various theories of law

[1]Kanishk Rai, [2]Bhavya Sheoran

[1]Kanishk Rai , Lecturer of Law & Assistant Dean (Blended LL.M. Programmes) at Jindal Global Law School, O.P. Jindal University (India) Email id: krai@jgu.edu.in
[2]2nd year law student , Jindal Global Law School, O.P. Jindal University (India), sheoranbhavya02@gmail.com

Abstract

The notion of contract formation, under the Indian Contract Act (ICA), has seen certain contentious claim rise vis-à-vis its construction. However, time and again, Indian Courts have shown their resilience to stick to the interpretation that has been passed onto us by the esteemed judges of the past. Nonetheless, can contract formation really be treated as a finished issue? Is the present understanding, one that has been extrapolated from the English Law on contracts, perhaps the most effective one? This paper has attempted to answer these questions. By looking at the historical development of the moment of contract formation under the ICA, it juxtaposes its hypothetical construction under a different theory of Law. This paper also examines the practicality of the aforementioned hypothetical construction by comparing it to the different models of contract law presently operating in both common law and civil law countries and suggesting possible reconstructions of the model of contract formation under the Indian Contract Act.

Keywords: Indian Contract Act (ICA), construction, English Law.

1. INTRODUCTION

Sections 4 and 5 of the Indian Contract Act, 1872 (ICA) have long been the reference point for the governance of the notion of acceptance. Generally speaking, the Indian model of acceptance detracts from the Common Law approach with regard to the fact that it identifies two points of acceptance- one at the end of the acceptor and the other at the end of the offeror. Naturally however, the approximately 150 years, since the drafting of the act and the inculcation of the reified 'postal rule,' have also entailed more than a few obstacles to the modern model of contract formation. This paper explores those very obstacles. It begins by first elucidating the model of contract formation under the Indian Contract Act. It then moves on to its genesis and the various theories of contract formation that presently function in the model legal systems around the world. The primary focus remains on the contested objectivity and broad applicability that the traditional perspective claims to have introduced by comparing its efficacy to other possible alternatives. Since the present model was to a large extent inspired by the English Law, this paper seeks to find out whether is this application the best possible one out there? Thus, this paper aims to reconstruct the moment of contract formation under the Indian Contract Act, by looking at various theories underlying them and their practical applications in the different legal systems of the world and ultimately stopping on the question of whether the application of it can be accessed via a case-by-case approach inspired by this paper's discussion on models followed by both the United Nations Convention on Contracts for the International Sale of Goods, and the German contract law.

2. Moment of Contract Formation

To understand contract formation under the Indian Contract Act, one must first begin by tracing it back to its genesis i.e., the English law. Before India had a codified act, judges often depended on the interpretation of English cases, and the English Common Law, to adjudicate on matters of contractual liability before the court. Thus, in order to understand the moment of contract formation under the ICA, one has to refer to its progenitor.

The notion of contract formation under English Law can be traced back to an 18th Century case Payne v. Cave, wherein it was held that an offeror was entitled to revoke his offer until the acceptor communicated their acceptance. It was this case that formed the foundation for Adams v. Lindsell (1817)- or rather, the theoretical model elucidated in it. When the matter came to the court, the central issue up for debate was that of 'deciding the moment of contract formation.' It was at this juncture that the 'mailbox rule' or the 'dispatch rule' was established. A theoretical concept that stated that an offer was to become a contract as soon as the acceptor mailed their acceptance. Two centuries have passed since: the 'mailbox rule,' however, has still remained extremely relevant to most legal systems around the world.

Section 4 of the Indian Contract Act, however, departs a little from the English model of contract formation in the sense that it technically lays down a dual requirement for communication of acceptance to be complete. Acceptance, as against the offeror, is complete as soon as the acceptor puts it in the course of transmission, whereas, as against the acceptor- when it comes to the knowledge of the offeror. Likewise, within the same section and further in section 5, one also finds the question of revocation too inscribed in a similar fashion. The key notion in it being that revocation is complete as soon as it comes to the knowledge of the person it is being made against. Because of the precarious wording of section 4, the question that naturally arose in the minds of our legal luminaries was that when could we actually say that a contract was concluded? – since if one were to follow the English approach, the contract would have been concluded as soon as the acceptor posted their reply, however, then, how would one situate the notion of revocation as provided under section 4 on behalf of the acceptor?

The Supreme Court provided an answer to this complexity in the case Bhagwandas Goverdhandas Kedia v. Girdharilal Parshottamdas:

> But s. 4 does not imply that the contract is made qua the proposer at one place and qua the acceptor at another place. The contract becomes complete as soon as the acceptance is made by the acceptor…When parties are in the presence of each other, the method of communication will, depend upon the nature of the offer and the circumstances in which it is made. When an offer is orally made, acceptance may be expected to be made by an oral reply, but even a nod or other act which indubitably intimates acceptance may suffice. If the offeror receives no such intimation even if the offeree has resolved to accept the offer, a contract may not result. But on this rule is engrafted an exception based on grounds of convenience which has the merit not of logic or principle in support, but of long acceptance by judicial decisions. If the parties are not in the presence of each other, and the offeror has not prescribed a mode of communication of acceptance, insistence upon communication of acceptance of the offer by the offeree would be found to be inconvenient, when the contract is made by letters sent by post.

Through this line of argument, the apex court maintained that while the Indian approach to the 'dispatch rule' might have differed in the way it was worded, it fundamentally retained a lot of features of its English counterpart. In doing so, the court thus ensured that Adams v. Lindsell was forever enshrined as the governing principle behind the intent of both section 4 and section 5- at least with respect to contract formation by post- with just one change: Acceptance could be revoked by the Acceptor if it had not yet come to the knowledge of the Offeror.

To understand the intent behind the deviation of the Indian contract law, one needs to consider two Scottish cases in particular- Dunmore v. Alexander and Dunlop v. Higgins . In the case of Dunmore, the central issue revolved around whether the letters (of both acceptance and revocation) reaching the intermediary at different times, which then forwarded to the offeror at the same time, could be constituted as a concluded contract. The court, by the

application of the 'Will Theory' held that under such a circumstance one could say that there did not exist consensus ad idem between parties since acceptance would have been effective only if it would have reached before the revocation. This was further brought upon in Dunlop where Lord Fullerton argued:

I find it necessary to make a distinction…between the binding effect of the acceptance when put into the post, as barring the offeror from founding on the implication that it was declined, and the absolute completion of the contract. I think the posting of the acceptance by the pursuers had most certainly the first effect. That having been done there was no silence on their part and consequently, the pursuers were barred from arguing that the offer must be held to have been declined. But I am by no means prepared to go farther, and to say, that in the larger question of the actual completion of the contract, the mere fact of the putting of the letter of acceptance into the post-office has the same effect as if it had not only been put into the post-office but had actually been delivered to the other party.

By scrutinizing the discourse around the binding effect of a contract vis-à-vis acceptance, the aforementioned cases thus provided (to some extent) a justification for the framing of section 4 with respect to the revised (Indian) 'mailbox' rule.

3. Theories of Law and Contract Formation

One can trace the organization of the English law of contracts to Robert Joseph Pothier's Traité des Obligations (1761). Joseph's piece detailed a version of the 'Will Theory' specifically in regard of contractual obligations. In it, he argued that it was the 'meeting of the minds' that was fundamental to the existence of any contract. This meeting of minds, when extrapolated in the model of contract formation was, according to him, the point when the acceptor sent their acceptance; thereby creating a contract. It was precisely this revelation that has also been argued to have inspired the creation of the 'mailbox rule' in Adams.

To continue, namely four theories primarily deal with defining the exact moment of contract formation:

1. Declaration theory.
2. Expedition theory.
3. Reception theory.
4. Information theory.

According to the declaration theory, a contract is formed the moment the acceptor declares their acceptance. Whether this declaration comes to the notice of offeror is immaterial. Similarly, the expedition theory too places the burden on the acceptor's actions. The only difference is that here the acceptor must complete an action necessary to communicate acceptance i.e., the dropping of a letter. Pothier's idea and the position of both English and Indian Contract Laws have thus always subscribed to the expedition theory. Likewise, both the reception and the information theory too have been construed analogously in nature (although completely opposite to both the declaration and expedition theory in substance). They place the burden of contract formation on the offeror. However, the difference within them is that while the reception theory believes that a contract is formed as soon as the offeror receives the letter of acceptance, the information theory necessitates knowledge of said acceptance i.e., the offeror must read it.

The expedition theory has firmly cemented itself within the Indian Contract Law model and its efficacy is one that if difficult to argue against. Nonetheless, this paper seeks confirmation on the fact that whether it truly is the most effective and apt for the Indian Demography.

4. Moral Theory of Contract

The significance of pinpointing the moment of contract formation cannot be understood in isolation; what it needs is a context. The effectiveness of any contractual agreement depends on its enforceability- that is to say- when does a party's contractual obligation arise. Thus, we first start by elucidating the justificatory basis of contractual obligation underlying both the reception and the information theory i.e., the 'Moral Theory of Contract.'

The 'Moral Theory of Contract' considers upholding one's moral duty of keeping one's promises as fundamentally necessary for

contractual obligation to arise. While there have been arguments that contest that it is rather utility that provides the justification of enforcement of contractual obligations, this paper believes that one should give consideration to Indrayan's argument concerning the entwining of the notion of morality with that of utility. In his paper, he argues that one can indeed harmonize the two; for it is the acts, that bring forth the greatest good, that are inherently moral.

The greatest practical application of the 'Moral Theory of Contract' is the legal principal known as the 'doctrine of good faith.' While the Indian act does not explicitly mention it, one finds a lot of common law countries recognizing its existence. Justice Leggatt's words, in the English case Yam Seng, here come to mind:

I respectfully suggest that the traditional English hostility towards a doctrine of good faith in the performance of contracts, to the extent that it still persists, is misplaced.

Moreover, the most explicit example of recognition of this principle can be seen in the 2014 case: Bhasin v. Hrynew. The Supreme Court of Canada- another common law (technically bi-jural) country- chose to elucidate this notion by terming it as the 'duty of honest performance.' It defined this doctrine as a basic requirement of honesty and goodwill on part of any contracting party with an aim to deter any attempts of misleading the other party. For that, according to the court, was a party's moral duty having promised something and subsequently contracted for it. With respect to how the court entwined morality with utility, it argued that the utility of enforcing such promises lay in the security it begot the other party. Thus, it was this very violation of security that essentially gave rise to a count of immorality; and subsequently a breach.

Now, a fundamental prerequisite to this notion of security, as discussed above, is the notion of equity. The analysis of Bhasin, or even for that matter any common law country's contract act, shows quite clearly as to how the equity between contracting parties is a notion that has always been central to an act of contracting- and the Indian Contract Law is not very different in that regard.

A prominent example of that is the explanation that Pollock and Mulla provide in their influential commentary when it comes to dealing with 'acceptance lost or delayed in transit' and even how it was handled by the court in Adams. Since one plausible downside of having the contract to be completed at the acceptor's place is that there is always the chance of it getting lost in transit and never reaching the offeror, they (Pollock and Mulla) elaborate on the balance that exists on both the sides i.e., while it is hard to deprive the acceptor of his rightful acceptance if everything they did was as expected, it is equally hard to string the offeror for an acceptance that they may or may not receive. They further also go on to explain that the reason why both the English and the Indian law favor the offeree, is because the proposer always has the option of protecting themselves by stipulating in the offer that they would not be bound by the contract until the acceptance is actually notified to them. The court, in Adams, also reasons along similar lines; further explaining that the only way that the offeror may rid themselves of any contractual obligation is if there is negligence on part of the acceptor in posting their acceptance. Therefore, in their true essence, one can essentially argue that both the Indian and the English law of contracts do work largely choose to work with a utilitarian viewpoint and only concede when there is a question of ensuring equity between both contracting parties- an act motivated solely by the desire of maximising happiness through fairness between parties.

The reason why the above explanation is important is because if equity is the guiding principle that ultimately directs when the moment of contract formation occurs, then perhaps it is the Moral Theory of Contract (and by extension, the reception, and the information theories of contract formation) that is much better suited to carry out that function. While one might theorize the concept of the 'offeror being bound to the offer rather than the contract' vis-à-vis section 4 and revocation, in a practical application, one still sees that the understanding of the legal systems still considers the offeror to be bound to the contract rather than the offer. Thus, one can essentially say that the present law does inherently create inequality on part of the offeror. Not only that, on the question of the offeror being able to prescribe the manner of acceptance, another argument that surfaces against the present 'equity' in the Indian contract law would be that it essentially requires the

offeror to still go an extra mile as opposed to the offeree. Mere existence of an option should not be considered as justification to enforce liability.

5. 'It does not matter if the acceptance reaches the offeror' ... Well, maybe it should!

The idea that a different theory, concerning the moment of contract formation, might be better suited to guide contractual agreements is not a novel one. This question has popped up time and again but perhaps most famously in Lord Justice Bramwell dissenting judgement in Household Fire Insurance v Grant, wherein he argument primarily revolved around the fact that the postal rule could hinder transactions and that acceptance should only be considered effective once the letter arrives. And sure enough, there do exist legal systems that choose to function away from the expedition theory.

A practical application of the receipt theory can be seen in The United Nations Convention on Contracts for the International Sale of Goods (CISG) [1980]. As per article 18(2):

An acceptance of an offer becomes effective at the moment the indication of assent reaches the offeror. An acceptance is not effective if the indication of assent does not reach the offeror within the time he has fixed or, if no time is fixed, within a reasonable time, due account being taken of the circumstances of the transaction, including the rapidity of the means of communication employed by the offeror.

This article read with Article 23 thus lays down that a contract is concluded as soon as the acceptance of the proposal reaches the offeror. Interestingly, one also finds the concept of 'being bound to an offer' too prescribed within the same convention. Article 16(1) states that:

Until a contract is concluded an offer may be revoked if the ¬revocation reaches the offeree before he has dispatched an acceptance.

Since the acceptance of the offer only becomes effective after it reaches the offeror, the period wherein the offeror cannot revoke the offer i.e., once acceptance has been dispatched, is when the offeror becomes bound to offer. Interestingly, this similarity, that CISG shares with the Indian Contract Law model (on the idea of the offeror becoming bound to offer), does differ in one regard- that is- how it tackles the notion of equity. Our above discussion has shown that when it comes to equity as per Indian Contract Law, the reason why the Indian model sways more towards the acceptor us because of the fact that if one were to not argue for completion at the side of the acceptor, one opens a pathway for the offeror to then act in bad faith by choosing to rather open scrutiny for 'breach of bindingness to the offer' than the contract itself; thereby mitigating liability. CISG's response to that exists within the same article i.e., 16(2):

However, an offer cannot be revoked: (a) if it indicates whether by stating a fixed time for acceptance or otherwise, that it is irrevocable; or (b) if it was reasonable for the offeree to rely on the offer as being irrevocable and the offeree has acted in reliance on the offer.

Since CISG came up as a mechanism to bridge the contractual gap between common and civil law jurisdictions, it is understandable that it retains some basic features of both models. While most of the basic principles of contractual obligations remain the same as that in common law, to conform to the notion of equality between both contracting parties, the convention also covers an exhaustive list of possible hypotheticals (as seen above) that might arise between them- something reminiscent of the civil contract law models. Nevertheless, it too is not devoid of its own share of controversies. One such argument advanced questions the implication of the wording of Article 16(2). While one might understand holding irrevocability when it is explicitly stated in any contract, the lines blur when it comes to tacit intentions. In cases where one only gives a fix period of time for acceptance, common law thus moves away from civil law in the sense that a mere mention of a time period does not contribute to irrevocability. The burden always begins by assuming revocability- something polar to the approach of the civil law system. While CISG's ambiguity in elucidating this case has ensured such a question does not have a unanimous application, legal scholars concede to the idea that answering it should be left on a court's interpretation for that particular case.

6. Moving Forward

Although CISG has been labelled as a daring move, its applicability is still restricted to the countries that ratify it. Furthermore, even in that, to acceptance by both parties to contract under it (as opposed one's legal systems). However, it cannot be disputed that CISG's existence and functioning does act as proof for the stable (at least to some extent) conflation of both civil and common law. Therefore, we find ourselves asking that whether does there exist any such scope for the model of contract formation under the ICA. Whether can such a model, driven by a different theory of contract formation, aptly and effectively replace the current model under the Indian Contract Law?

To explore that question, one must turn to the German law of contracts; where a concluded contract consists of three separate events (or, mini contracts) to authenticate legality. To understand the model, consider the following example:

The contractual timeline of a transaction for the sale of a pen can be understood as the happening of three events. The first one, contract for sale, is understood to happen when the parties complete an agreement to buy and sell the pen. The second event is differentiated by the act of the transfer of the commodity (in this case the pen) from one party to the other. The last event is the transfer of the consideration for said commodity (for e.g. If I was buying the pen from you for 20 rupees). It is only after these three events can one say that the contract stands concluded.

By separating them as three events, German Contract law considers their liability individually as per each breach. Our above interactions have shown us how as to in the Indian contract act, even though one might argue that the offeror is bound to the offer than the contract, one still sees that the liability attached to it remains tantamount to breaching a contract- an unfair position for the offeror. Thus, going from a utilitarian perspective, the German law of contracts does much better than the ICA. It penalises a party only for the particular breach of responsibility that they commit and not for the entire contract itself.

However, the above-described changes as explained above need not be implemented absolutely. They cannot be held to be a case of 'this or that.' Rather, a change of application of different models can always be made on case-by-case approach. As shown by our discussion on both the ICA and CISG, not only does one require a shift in the moment of contract formation from the acceptor to the offeror, but such a change, in light of our proposed application of the German law, does also necessitate a case-by-case analysis specifically in relation to the first event and its revocation and acceptance i.e., the contract for sale.

7. Conclusion

Contract formation in any legal system has always been a hot topic of debate. So have the theories underlying them. A basic necessity for the formation of any contract, and even more so in the present times, has been equality between the parties. For without equality there can never be any contract in good faith either for the individuals or for society at large. This need for equality is what drives the main narrative of this paper forward- that is- it is time for a change to maintain this equality. An inherent property of common law is to adapt with changes to society. While the 'mailbox rule' might have been the closest to brining parity between both parties, modern times, and technology beckons us to move on. However, to blindly mover forward is a folly. Thus, this paper attempts to act as a guiding light to explore for alternatives that might usher us into the glorious new era. While it is true that this the Indian model has been operating in the new era for a while now without any glitches, it should not be something we should settle on. Ignoranita Juris Non Excusat. Justice cannot remain ignorant and waiting for the courts to change it if the need ever arose is a big folly. The nation's brightest light cannot be kept in the dark.

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