Freedom of Contract and Its Limitation

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1. Introduction

Prominent among nineteenth century judicial statements that have an air of profundity and seem to enshrine some underlying assumption of law is the remark by Sir George Jessel, M.R., that "if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced b**y** Courts of justice. Therefore you have this paramount public policy to consider-that you are not lightly to interfere with this freedom of contract."[1] More recently, the same sentiment was voiced by Lord Morris in the House of Lords when he said: "the policy of the law is to uphold freedom to contract."[2] On the surface, therefore, little seems to have changed. English law still appears to hold firmly to the view that the parties to a contract are free to enter into what-soever bargain they may desire, subject only to the bounds of legality, which no judge has ever stated to be irrelevant. The late Dean Pound pointed out that this assertion of the idea of freedom of contract was a nineteenth century development, taking the place of earlier notions, such as the theory of an equivalent and the theory of the inherent moral force of a promise made as such. In the light of the comments made by Professor Wolfgang Friedman on the changing nature of the social function

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[1] Printing & Numerical Registering Co. vs. Sampson, L.R.19 Eq. 462, at 465, (1875)

[2] Esso Petroleum Co.v. Harper's Garage (Stourport) Ltd., [19671 1 All E-R. 699, at 712

of contract,[3] the re-affirmation of this notion in England in 1967 may be received with some surprise. But does the categorical, emphatic pronouncement of Lord Morris, with its echoes of the classical age of English jurisprudence, truly represent the present state of the English law of contract? Is there complete freedom of contract in modem English law? Beyond this there lies the further question: should freedom of contract be permitted in any absolute form? My intention in the present essay is to consider some at least of the ways in which English law restricts and regulates freedom of contract, and to examine the desirability or otherwise of control over such freedom.

The tendency of modem law, therefore, is away from the principle of freedom of contract. It may be that there is a long way to go before utter regulation of contractual relationships is the rule, rather than the exception. But the signs to be found in the cases, it is suggested, point to a movement towards such a situation. The nineteenth and early twentieth century's produced the golden age of contract. Are we seeing a gradual decline in the importance of contractual relations, revulsion from the supremacy of the individual and the individual's will? [4]

2. Meaning and Concept of Freedom of Contract

Freedom of contract means *parties are free to enter into any contracts* and determine content of the same. The doctrine which states that people have the *right to legally bind* them is known as freedom of contract. Freedom of contract is a judicial concept which holds that contracts are based on mutual agreement and free choice. Freedom of contract is the *freedom of private* or *public individuals* and *groups* (of any legal entity) to form nonviolent contracts without government restrictions. Contracts are not be hampered by external control such as governmental intervention.

3. Freedom of Contract The doctrine that people have the right to bind themselves legally; a judicial concept that contracts are based on mutual agreement and free choice, and thus should not be hampered by external control such as governmental interference. This is the principle that people are able to fashion their relation by private agreements, esp. as opposed to the assigned role of the feudal system. As Maine famously said, the

[3] W. FREIDMANN, LAW IN A CHANGING SOCIETY, Sweet& Maxwell, Universal Book Traders, Delhi, 97-113. 1964).

[4] G. H. L. Friedman, Freedom of Contract, OTTAWA LAW REVIEW, Volume 2:1,at 22

movement of progressive societies has been a movement from status to contract."[5] Freedom of contract embraces two closely connected, but two different concepts. **Firstly,** it indicates that contracts were based on mutual agreement. **Secondly,** it emphasizes that the creation of a contract was the result of a **free choice** unhampered by external control including the government or the legislature.

The concept of freedom of contract has two meanings. The first is the freedom of a party to choose to enter into a contract on whatever terms it may consider advantages to its interests, or to choose not to. Contractual obligation is thereby attributing to the will of the parties. This was one of the cornerstones' of nineteenth - century laissez-faire economics. Adam smith in his wealth of nations, published in 1776, offered the first systematic account of economic affairs championing the cause of freedom of trade against the economic protectionism current at that time, and freedom of contract was taken up as an ideal into classical economic theory.

When, therefore, in 1861, Sir Henry Maine wrote his Ancient law, he postulated that the movement of progressive societies had hitherto been a movement fro, status (with its entrenched protection of privilege by legal and social restrict ions) to contract. He considered this movement to be not only desirable, but inevitable. Imperative law, he said has abandoned the largest part of the field which it once occupied ad has left men to settle rules of conduct for themselves with a liberty never allowed to them till recently.

But freedom of contract also referred to the idea that as a general rule there should be no liability without consent embodied in a valid contract. This second and negative aspect of freedom of contract was influential in narrowing the scope of those parts of the law of obligations which deal with liability imposed by law tort and restitution.

Today the positions are seen in a different light. Freedom of contract is generally regarded as a reasonable social ideal only to the extent that equality of bargaining power between contracting parties can be assumed, and no injury is done to the economic interests of the community at large. In the more complicated social and industrial conditions of a collectivist society it has ceased to have much idealistic attraction except, perhaps, to the proponents of a completely free market economy, who have advanced it in

[5] BLACK'S LAW DICTIONARY (9th edition, (1979)

recent years in a modern and sophisticated way, some using the tools of micro-economic analysis. But whatever its status may be as an ideal, the concept of freedom of contract has suffered severe inroads as the result of developments in modern social life and policy.[6]

In the first place, statute law today interferers at numerous points with inroads into the freedom of the parties to make what contract they like. The relations between employers and employed, Freedom of contract is also affected by statutorily imposed implied terms which set the default rule, although in certain circumstances this can be varied by the parties. There are also wide-ranging statutory restriction on discrimination on the grounds of sex and race in the provision of goods, facilities and services, and in the selection of employees and in the terms upon which they employed. These are a significant departure from the general freedom at common law to refuse to contract. Although these primarily give rise to compensation orders, they can exceptionally lead to specific relief. The prohibition on discrimination in the provision of goods, facilities, and services applies where the provision is made to the public or a section of the public.[7]

Secondly, most contracts entered into by ordinary people are not the result of individual negotiation. An employee's contract of employment for example, will often be determined by a collective agreement made between trade unions and employers. Standard from contracts are also frequently used, even between businesses. These will lay down the terms on which the suppliers are prepared to do business, or embody or incorporate by reference the term of a trade association. The freedom of the parties to negotiate is limited by such standard from contracts. Although a party often a consumer, is free to decide not to deal with a particular retailer and to negotiate parties, delivery dates and so on, in many areas similar terms will be offered by other retailer so that the individual has either to accept the terms laid down in to, or go without. Since however, it is not feasible to go without many such goods or services, the individual is effectively compelled to adhere to those terms. In certain types of standard from contracts, however, for example those for the charter of ships, the standard from is often extensively modified or supplemented by other terms extensively modified or supplemented by other terms appropriate to the particular charter party.[8]

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[6] J.BEATSON,QC, ANSON'S LAW OF CONTRACT, Oxford University Press, at 4, 27 Ed, (1998)
[7] Ibid ,at 5
[8] Ibid at 5

Thirdly, in the case of utilities such as water or electricity, which are in effect necessities of modern life, but the supplier is a monopoly or near monopoly, there may be a compulsion to supply, at least domestic consumers. Under the legislation regulating such utilities, including gas and telephones where it may now be possible to choose an alternative supplier, there is a duty to supply those who wish to be supplied there are prohibitions on undue preference and undue discrimination, and statutory regulator is given power to control prices and other terms of supply. This may be modern equivalent of the common law duty on common innkeepers and common carriers to serve all comers on a reasonable basis, probably because of their monopoly or near monopoly position. These common law doctrines have not however, been developed and the field has been left to the anti-discrimination legislation and that for the control of monopolies and restrictive trade practices and for regulating utilities. Where there is a statutory obligation to supply and no or little power to negotiate about the incidents of the relationship, the courts may regard its compulsory nature as incompatible with its being contractual.[9]

Finally, the negative aspect of freedom of contract sits uneasily with the practice of implication of terms into the contract, and the use of the standard of reasonableness as a way of dealing with gaps in the contractual language. Terms are implied not only under statute, but also at common law. Although the basis of such implication is said to be necessity or in the case of custom presumed consent in many cases this is rather artificial, and in truth in many standard transactions the implied terms are the legal incidents of the transaction, from which the parties are subject to subject to statute, often free to deviate freedom of contract is also difficult to reconcile with the adoption of the objective theory which provides in essence, that a person , that a person (A) whose conduct is such that the other party reasonably believes that A has assented to the terms of a contract, will bound no matter what A's real intention is . This rule can lead to the imposition of non-consensual obligations, since what creates the obligation is not consent infect but acting as if consent is being given.[10]

Notwithstanding that, in many areas of contract, freedom of contract in the classical sense is manifestly lacking, English law and English judges to a great extent proceed on the assumption that parties are free to choose

[9] Ibid, at, 6
[10] Id

whether or not they will enter into a contract and on what terms. We have noted the formulation of the test for implied terms,

4. Principle of Freedom of Contract

A basic principle of the common law of contract is that the parties are free to determine for themselves what primary obligations they will accept. It may be objected that the general principles of contract law therefore present an inadequate, if not distorted, picture of modern economic life. This may be so, but it is nevertheless the fact that the law does still rest on the *assumption of freedom of choice*, and where a relationship is entered into in which there is no choice, a court may hold that it is not contractual.[11] The freedom of contract is the foundation of laissez-faire economics and is a keystone of free- market libertarianism. The freedom of Contract as a ***principle of the private law,*** evoking the autonomy of the will theory as a fundament for the freedom to contract and toward systemically enunciating the competing theories and the decline of the actual ***autonomy of the will*** theory[12]

(i) Principle of the Private law: The freedom of contract principle, stipulating that parties are free to enter into any contracts and determine content of the same. The freedom of contract principle the requirement of good faith which must be met both in contract negotiation and execution, and contract implementation, and which can neither be conservatively removed nor restricted. The doctrine of freedom of contract has always been respected by the Law, which allows parties to provide for the terms and conditions that will govern the relationship. Principle of contractual freedom is left available by "**law", "Public order"** and "**morality" [13]**

(ii) The autonomy of will: The freedom of contract is based on the ***autonomy of will*** and it is a necessary consequence of the autonomy of will and its greatest achievement. The freedom of contract is **acknowledged to all persons**, except for the cases of **incapacity** and **prohibition laid down by law.**

5. Limitations of the Freedom of Contract: Limitations of the Freedom of Contract are:

A) Law as a limitation of the freedom of Contract

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[11] Ibid, at, 7

[12] Adam , Ioan , - Drept civil Obligaþiile Contractual , Bucharest, C.H.Beck Publishing House, at 28, (2011)

[13] **EUGENIA VOICHECI,** FREEDOM OF CONTRACT AND ITS LIMITATION IN THE ROMANIAN CIVIL CODE, Challenges of the Knowledge Society. Private Law "Nicolae Titulescu" University, at 417

B) Public order as a limitation of the freedom of Contract and

C) Morality as a limitation of the freedom of Contract

A) Law as a limitation of the freedom of Contract: limitations laid down by law concerning the **capacity to contract**, also known as **incapacities;** incompatibilities and termination of rights concerning certain persons; prohibition laid down by law to enter into certain types of contracts; prohibition to enter into contracts with certain subject matters.

Capacity means the ability to do something. Contract is the voluntary agreement between two or more parties that is enforceable by law as a binding legal agreement. According to Section 2(a) of Nepalese Contract Act, 2056, "contract means an agreement enforceable by law concluded between two or more parties for performing or not performing any work."[14] In the same way, according to section 504 (1) of National civil Code 2074 " If an agreement enforceable by law is made between two or more persons to do or abstain from doing any act, a contract shall be deemed to be made. Section 504(2), for the purposes of sub-section (1), a contract shall be deemed to be made once the person to whom an offer has been made by another person communicates his or her acceptance thereto. Section 504 (3), Once a contract is made, a binding legal relationship shall be created between the parties to it."[15]

Capacity to contract means the legal competence of a person to enter into a valid contract. It is a legal capacity to form a binding contract. Simply, it is a capacity to enter into a legal agreement and the competence to perform some act. For the valid contact, the parties to the contract must have contractual capacity. Parties must be competent to make contract. According to Sec.3 of Nepalese Contract Act, 2056, the following person is competent to conclude contract:

- Person who have attained 16 years of age.
- Person having the sound mined
- Person who is qualified by law.[16]

According to Section 506 (1) of National Civil Code 2074 every person other than the following persons shall be competent to make contract:

[14] Contact Act, Sec. 2(a), (2056 B.S.)
[15] Country (Muluki) Civil (Code), Sec. 504, (2017)
[16] Contact Act, Sec. 3, (2056 B.S.)

(a) One who is a minor?
(b) One who is of unsound mind?[17]

Explanation:

(1) A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he or she is of sound mind.

(2) A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he or she is of unsound mind.[18]

Section 506 (2), notwithstanding anything contained in sub-section (1), any person who is deemed incompetent to make a particular contract under the law shall not be deemed to be competent to make such contract.[19] Section 506 (3), In concluding a contract on behalf of a person who is incompetent or quasi-competent, his or her guardian or curator may make such contract.[20] Section 506 (4), in concluding a contract on behalf of a legal person, it shall be made by decision of the director or directors authorized for the management and operation of such person or by a person authorized by such director or directors.[21] Section 506 (5),Notwithstanding anything contained elsewhere in this Section, if a person deemed to be incompetent to make a contract under this Chapter on any particular matter is competent by other law to make contract on such matter, such person shall be deemed to be competent to make contract on that matter.[22]

Incapacities are strictly related to the capacity to apply a right; the sanction for the failure to comply with the capacity to apply a right is the **cancellation of the document,**

- existence of the capacity to use
- existence of the capacity to apply
- Person incompetent to contract
  i) Minor
  ii) Person of unsound mind
  iii) Person disqualified by law

Minor Person who has not attained the age of majority, The age of majority in Nepal is 18 years from 17 August, 2018 A.D. (2075-05-01 B.S.) In past at

[17] Country (Muluki) Civil (Code), Sec. 506, (2017)
[18] Ibid
[19] Ibid at Sec. 506 (2)
[20] Ibid Sec. 506 (3)
[21] Ibid at Sec. 506 (4)
[22] Ibid at Sec. 506 (5)

common law, people below 21years was consider as minor, today it has changed. In England, the age of majority was changed 18 years after the family law reform Act 1969. USA also reduces the age of majority to 18 years.

According to Section 13(j) of Nepalese Contract Act, 2056 and Indian Contract Act1872, section 11, a minor contract is void absolutely. According to Section 517(4) (j) of National Civil Code, 2074 " A contract made by a person not competent to make contract"[23] Contract with minor is void abinitio because; they don't know the result of their act. They cannot analyze the benefit and losses. The rules regarding minor agreement are:

a) Minor's agreement is void from the beginning.
b) A contract for minor's benefits is valid.
c) Minors can always plea infancy.
d) Estoppel does not apply to a minor.

Person of unsound mind Parties should have necessary mental capacity to have contract. A person is competent to contract if he is able to understand the nature and effect of his act. Essential elements of valid contract, Soundness of mind depends on two facts:

- His capacity to understand the content of the business concerned.
- His ability to form a rational judgment as to its effect on his interest.

Nepalese Contract Act, 2056 has not given any definition of sound mind. Section 3(1) (b) has made a provision that person of unsound mind is incompetent to contract. The categories of unsound mind are:

- Mental illness (lunatic)
- Idiots
- Drunkenness

Person Disqualified by Law Individual or person who becomes ineligible as per the prevailing law, As per Nepalese Contract Act, 2056, the person who is disqualified by law lacks the capacity of contract. The contact done by disqualified person is void. Incompetency of contract may arise from the status like legal, political, professional, diplomatic, Corporate etc. Person disqualified by law on the basis of the status are:

- Professional people
- Enemy alien

[23] Ibid, Sec. 517(4) (j)

- Foreign sovereigns and diplomats
- Insolvents
- Corporation
- Married women

B) Public order as a limitation of the freedom of Contract: Public order is a concept with an economic dimension, apparent in monetary and price policy, loan policy and economic planning, a fundamental dimension that influences the existence and evolution of contractual relations with economic content. The goal of the "contractual justice" of public order is thus extended from the individual consumer considered a vulnerable (disfavored) contractor in its relations to the professionals to the "weak entrepreneur", involved in the same type of legal relations, which protection is legislatively acknowledged for consumers.[24]

C) Morality as a limitation of the freedom of Contract: A concept that seems to "say" everything from the very beginning, but that is as evanescent as smoke and the institution of "good faith", morality has always censored the extent and even the substance of contracts entered into individuals, Believe morality is "the totality of conduct rules shaped in society's conscience, the compliance of which became imperatively compelling by extensive experience and practice, for achieving the general interests of a given society". Other side of morality is empirical, based on sociological rules regarded as natural habits or habits acquired by tradition and education, centered on the idea of "good" and "bad".

5. Conclusion

Freedom of contract is a judicial concept which holds that contracts are based on mutual agreement and free choice. Freedom of contract embraces two closely connected, but two different concepts. Firstly, it indicates that contracts were based on mutual agreement. Secondly, it emphasizes that the creation of a contract was the result of a free choice unhampered by external control including the government or the legislature. The significance of the role played by contract in any economic system can scarcely be denied. The issue is the extent to which the law does, or should, assume that parties enjoy freedom of economic decision when entering into contracts. The doctrine which states that people have the right to legally bind them is

[24] TURCU, ION; POP, Liviu – *Contracte comerciale. Formare si executare*, vol. I, Bucharest, Lumina Lex Publishing House, at 15-16, (1997)

known as freedom of contract. The doctrine of freedom of contract has always been respected by the Law, which allows parties to provide for the terms and conditions that will govern the relationship. The Principles of European Contract Law, however, state that this freedom is subject to the requirements of good faith, fair dealing and the mandatory rules established under the Principles. The freedom to contract as a principle of the private law, evoking the autonomy of the will theory as a fundament for the freedom to contract, The effort was also directed toward presenting the restraints of the freedom to contract, as they are stated in the Civil Code and the different categories of contracts which are the consequence of those restraints.

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