Mercantile Laws -I

DMGT102

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MERCANTILE LAWS-I

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SYLLABUS

Mercantile Laws-I

Objectives: To teach the fundamentals of contract and related Acts and laws related to partnership, negotiable instruments and insurance contracts.

Sr. No.	Content
1	Law of Contract: Definition, Nature and Classification of Contracts.
2	Offer and Acceptance, Consideration.
3	Capacity to Contract, Free Consent
4	Discharge of Contract, Remedies for breach of contract and Quasi Contracts.
5	Indemnity and Guarantee, Bailment and Pledge
6	Agency- its creation, Personal Liability ofAgent, Sub Agent and Substituted Agent, Termination of Agency.
7	Law of Partnership: Definition an Nature, Registration of firm, Rights and Duties of apartner, types of partners, and dissolution of firm, Limited Liability Partnership.
8	Law of Sale of Goods: Sale of Goods, Conditions and Warranties.
9	Transfer of Ownership, Rights of Unpaid Seller.
10	Negotiable Instrument Act-Definition, Types, Parties, Dishonour of negotiable instrument and Crossing of cheque, Bouncing of cheque.

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Unit 1: Law of Contract

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Objectives

After studying this unit, you will be able to:

- Explain meaning of contract
- Discuss essential of valid contract
- Describe classification of contract

Introduction

As you all know that we enter into contracts every day. Some of these are made consciously, for example, purchase or sale of a share of a company or a plot of land. Sometimes we do not even realise that we are making a contract, e.g., hiring a taxi, buying a book, etc. In any case, a contract, howsoever made, confers legal rights on one party and subjects the other party to some legal obligation. In the case of people engaged in business, they carry on business by entering into contracts. Thus, the business executives, corporate counsels, entrepreneurs, and professionals in different fields deal frequently with contracts. At times, they have to draft one such contract or scrutinize it or provide inputs to its making or even interpret it. Therefore, it is necessary for them to know what constitutes a contract. The law relating to contracts is contained in the Indian Contract Act, 1872. For business executives, contract law is tremendously significant because it underlies or is related to all major areas of law affecting business.

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1.1 Meaning of Mercantile Law

Mercantile Law may be defined as that branch of law which prescribes a set of rules for the governance of certain transactions and relations between: (i) Business persons themselves, (ii) Business persons and their customers, dealers, suppliers, etc., and (iii) Business persons and the state. In the context of Indian business some of these transactions and relations concern the following:

1. Regulation of restrictive and unfair business practices,
2. Foreign exchange management and regulation,
3. Insolvency of business persons,
4. Promotion of conciliation, and arbitration for settlement of business disputes,
5. Regulation of companies incorporated under the Companies Act, 1956.

Nature of Law

1. Negotiable instruments,
2. Patents, trademarks and copyrights,
3. Actionable claims, factoring and forfeiting,
4. Import and export regulation,
5. Contracts, sale of goods, guarantee, indemnity, bailment, pledge, charge, mortgage, partnerships, insurance, carriage of goods,
6. Prevention of food adulteration, regulation of essential commodities,
7. Regulation of stock exchange and financial securities,
8. Regulation and development of industries,
9. Economic offences,
10. Conservation of foreign exchange and prevention of smuggling activities,
11. Regulation of foreign contributions, foreign capital,
12. Excise, import and export duties, tax on income, wealth, etc.

1.1.1 Objectives

From the description of the nature and meaning of business law, it can be inferred that the subject has many objectives to achieve. Firstly, law lays down the framework within which business activities shall be carried out. For example, X Company issues an advertisement disparaging the products of its rival – Y Company. Further X Company prohibits its dealers to deal in the products of Y Company. Company is not in conformity with some legal rules prescribed by some statute or the other. Thus Y Company can enforce their rights which have been infringed by the X Company.

Secondly, a business person can resort to various judicial and quasi-judicial authorities against the government in case his legal rights have been violated.

Thirdly, some laws are made to facilitate the business persons to achieve their goals smoothly. For example, business has been extended the facility of doing business by getting a company incorporated, deriving all the advantages of incorporation, such as separate legal entity, limited liability, etc.

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Fourthly, business law has social objectives too. The anti-competition laws, the pollution control laws, etc., are some of the examples. Further, laws concerning regulation of essential commodities and prevention of food adulteration in the interest of the consumers go a long way in serving social objectives.

Lastly, business laws aim to prevent concentration of economic power and help in the adjustment of claims of individuals against each other.

1.1.2 Sources of Indian Business Law

The sources of Indian mercantile law are:

1. ***Statutes*** such as the Indian Contract Act, 1872, the Sale of Goods Act, 1930, the Partnership Act 1932, the Negotiable Instruments Act, 1881, the Insurance Act, 1938.
2. ***Common law:*** In the absence of a legal provision on a subject, the Indian courts apply English Common Law. Even in interpreting Indian law, the Indian courts refer to English decisions.
3. ***Custom and usages:*** The Indian business customs and trade usages, unless excluded by a statute, are allowed to govern business transactions. The Negotiable Instruments Act, 1881, has not excluded the trade usage of 'hundis' as negotiable instruments.
4. ***Precedents:*** Courts make law too. Their main contribution comes in the form of decisions in law suits. The cases decided by the Supreme Court and other courts have served as precedents to follow by the lower courts.
5. ***Justice, equity and good conscience*****:** The equitable principles of law developed by the English 'equity' courts are the guiding force behind most of the Indian statutes on business laws. Also as and when necessary, the Indian courts make use of these principles of equity in interpreting the Indian law.

1.2 Contracts

A contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another. If the party, which had agreed to do something, fails to do that, then the other party has a remedy.

Example: D Airlines sells a ticket on 1 January to *X* for the journey from Mumbai to Bangalore on 10 January. The Airlines is under an obligation to take *X* from Mumbai to 10 January. In case the Airlines fail to fulfil its promise, *X* has a remedy against it. Thus, *X* has a right against the Airlines to be taken from Mumbai to Bangalore on 10 January.

A corresponding duty is imposed on the Airlines. As there is a breach of promise by the promisor (the Airlines), the other party to the contract (i.e., *X*) has a legal remedy.

Privity of Contract

As a contract is entered into by two or more persons thereby creating rights and obligations for them, it is a party to the contract only who can enforce his rights as against the other party (i.e., the promisor). The basic principle underlying law of contracts is that a stranger to a contract cannot maintain a suit for a remedy. The law entitles only those who are parties to the contract to file suits for exercising their rights. This is known as 'privity of contract'. This rule can be traced to the fact that the law of contracts creates *jus in personam* as distinguished from *jus in rem*. Therefore, a stranger to a contract cannot maintain a suit.

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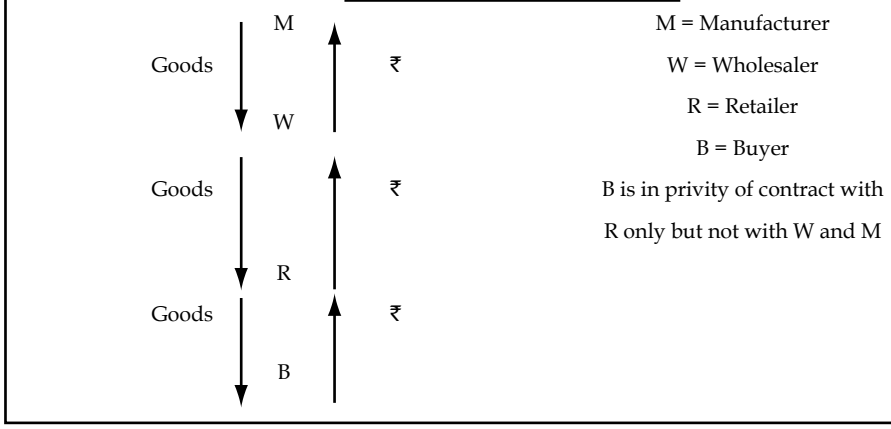
Example: A is indebted to *B*. *A* sells certain goods to *C*.*C* gives a promise to *A* to pay off *A*'s debt to *B*. In case *C* fails to pay, *B* has no right to sue *C*, being a stranger to the contract between *C* and *A*. In other words *C* is not in privity with *B*. However, *C* is in privity with *A*.

Figure 1.1: Privity of Contract



Formation of a contract: There are different modes of formation of a contract. It may be made in writing or by word of mouth, or be inferred from the conduct of the parties or the circumstances of the case.

Note You should be concerned about contract law because it determines how parties to the contract will need to keep the promises they make. Although very few contracts ever end up in court, if the parties to a contract disagree on something and are unable to resolve the disagreement, they may have to resort to the judicial process.

Task S, a singer, contracts with M, the manager of a theatre, to sing at the latter's theatre for two evening in every week during the next two months. M engages to pay her ₹ 300 for each evening's performance. On the seventh evening, S willfully absents herself from the theatre. M, in consequence, wants to rescind the contract and claim compensation for the loss suffered by him through the non-fulfilment of the contract by S. Advise. [***Hint.*** M is entitled to rescind contract and claim compensation. s.75]

1.3 Classification of Contracts

Contracts may be of different types based on (i) Validity or enforceability, (ii) Mode of formation and (iii) Performance.

1.3.1 Classification of Contracts According to Formation

A contract may be (a) Made in writing (b) By words spoken and (c) Inferred from the conduct of the parties or the circumstances of the case. Accordingly, contracts may be classified according to the mode of formation as express contracts and implied contracts. If the terms of a contract are expressly agreed upon (whether by words spoken or written) at the time of the formation of

the contract, the contract is said to be an express contract. An implied contract is one which is inferred from the acts or conduct of the parties or the course of dealing between them.

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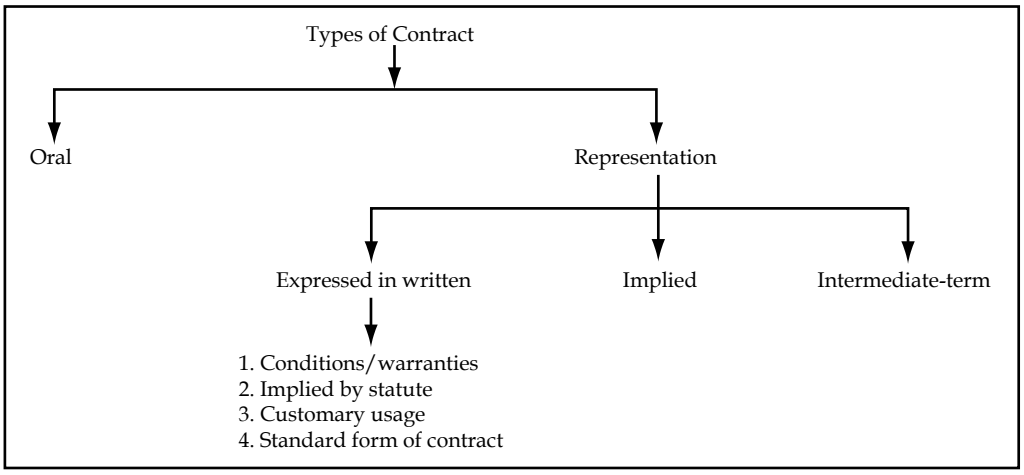

Contracts need not be in Writing

The terms of a contract may be stated in words (written or spoken). This is an express contract. Thus, there may be a verbal or oral contract. Also the terms of a contract may be inferred from the conduct of the parties or from the circumstances of the case. This is an implied contract.

Example: A enters into a public transport, for going to his destination. The law will imply a contract from the very nature of the circumstances, and he will be obliged to pay for the journey.

Contracts and Documents to be in Writing

There are certain contracts and documents which are required to be in writing and are to be signed by the parties thereto. Some of these are:

1. A bill of exchange, cheque, promissory note, etc., under the Negotiable Instruments Act, 1881.
2. A memorandum of association of a company registered under the Companies Act, 1956.
3. An articles of association of a company registered under the Companies Act, 1956.
4. An application for shares in a company.
5. An application for transfer of shares in a company.

Contracts and Documents which are required to be registered

There are some contracts and documents which are required to be not only in writing but, in addition, are required to be registered with some competent authority or the other. Some of these are:

1. Transfer of immovable property, i.e., lease, sale, mortgage or gift thereof.
2. A memorandum of association of a company.
3. An articles of association of a company.

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4. Mortgage and charges of properties by a company.
5. Documents coming within the purview of the Registration Act, 1908.

An implied contract may be implied in fact or implied in law. Contracts implied in fact and contracts implied in law are not really contracts at all. They are remedies devised by the courts. Courts apply them when the legal requirements of Indian Contract Act, 1872 for contract formation do not exist, but it would be grossly unjust to permit one party to benefit – without paying – from what he received from the other.

A contract implied at law, also called a quasi-contract, is an obligation imposed by a court to do justice between the parties even though they never exchanged, or intended to exchange, promises. In this instance, a court implies a contract to prevent one party's unjust enrichment at the other's expense.

1.3.2 Formal and Informal Contracts

A formal contract is one to which the law gives special effect because of the formalities or the special language used in creating it. The best example of formal contracts is negotiable instruments, such as cheques. Informal contracts are those for which the law does not require a particular set of formalities or special language. Sometimes informal contracts are called 'simple' contracts.

1.3.3 Classification According to Validity

Contracts may be classified according to their validity as (i) Valid, (ii) Voidable, (iii) Void, (iv) Unenforceable (v) illegal.

A contract to constitute a valid contract must have all the essential elements discussed earliers. A voidable contract is one which may be repudiated (i.e., avoided) at the will of one or more of the parties, but not by others. Until it is so repudiated it remains valid and binding. It is affected by a flaw (e.g., misrepresentation, fraud, coercion, undue influence), and the presence of any of these defects enables the party aggrieved to take steps to repudiate the contract. It shows that the consent of the party, who has the discretion to repudiate, was not free.

Example: A, a man enfeebled by disease or age, is induced by B's influence over him, as his medical attendant to agree to pay B an unreasonable sum for his professional services. A can avoid the contract. A's consent is not free; it is affected by undue influence employed by B. A can take steps to set the contract aside.

If the party entitled to avoid the contract fails to do so within a reasonable time, he will be estopped from avoiding it if the other party has altered his position to his prejudice or a third party has acquired some rights in a *bona fide* manner.

Example: A purchased certain goods from B by making a misrepresentation of some facts. Later B comes to know about the representation made by A. However, B does not, within a reasonable time, repudiate the contract. A sells those goods to C, a *bona fide* purchase for value. C's title shall be a good title.

An agreement which is not enforceable by either of the parties to it is void *ab initio* such an agreement is without any legal effect. Under s.11, an agreement with a minor is void. Sometimes, a contract is valid at the time of formation, but may become void afterwards.

Example: A contracts to take indigo for B to a foreign port. A's government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

Notes

An illegal agreement is one that the courts will not enforce because the purpose is to achieve an illegal end. Illegal contract are those contract that are forbidden by law. All illegal contracts are void. Because of the illegality of their nature they cannot be enforced by any court of law. Infact even associated contracts cannot be enforced. Contracts which are opposed to public policy or immoral are illegal. Similarly contracts to commit crime like supari contracts arte illegal contracts.

1.4 Essential of Contract

According to Section 10, "All agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void". As per the above section, a contract must have the following elements.

Intention to create legal relationship: The parties entering into a contract must have an intention to create a legal relationship. If there is no intention to create a legal relationship that agreement cannot be treated as a valid contract. Generally there is no intention to create a legal relationship in social and domestic agreements.

Example: Invitation for lunch does not create a legal relationship. Certain agreements and obligation between father and daughter, mother and son and husband and wife does not create a legal relationship. An agreement wherein it is clearly mentioned that "this agreement is not intended to create formal or legal agreement and shall not be subject to legal jurisdiction in the law of courts" cannot be treated as a contract and not valid.

Lawful Object: The objective of the agreement must be lawful. Any act prohibited by law will not be valid and such agreements cannot be treated as a valid contract.

Example: A rents out his house for the business of prostitution or for making bomb, the acts performing there are unlawful. Hence such agreement cannot be treated as a valid contract. Therefore the consideration as well as the object of the agreement should be lawful.

Agreement not expressly declared void: Sections 24 to 30 specify certain types of agreement which have been expressly declared void.

Example: Restraint of marriage which has been expressly declared void under Section 26. If John promises to pay $50 to Mary if she does not marry throughout her life and Mary promise not to marry at all. But this agreement cannot be treated as a valid contract owing to the fact that, under section 26 restraint of marriage expressly declared void. Some of the agreements which have been expressly declared void are agreement in restraint of legal proceedings, agreement in restraint of trade, agreement in restraint of marriage and agreement by way of wager.

Proper offer and its acceptance: To create a valid contract, there must be two or more parties. One who makes the offer and the other who accepts the offer. One person cannot make an offer and accept it. There must be at least two persons. Also the offer must be clear and properly communicated to the other party. Similarly acceptance must be communicated to the other party and the proper and unconditional acceptance must be communicated to the offerer. Proper offer and proper acceptance should be there to treat the agreement as a contract which is enforceable by law.

Free Consent: According to section 14, consent is said to be free when it is not caused by (i) coercion, (ii) undue influence (iii) fraud, (iv) misrepresentation, or (v) mistake. If the contract made by any of the above four reason, at the option of the aggrieved party it could be treated as a void contract. If the agreement induced by mutual mistake the agreement would stand void

Notes

or canceled. An agreement can be treated as a valid contract when the consent of the parties are free and not under any undue influence, fear or pressure etc. The consent of the parties must be genuine and free consent.

Capacity of parties to contract: Parties entering into an agreement must be competent and capable of entering into a contract. If "A" agrees to sell a Government property to B and B agrees to buy that property, it could not treated as a valid agreement as A is not authorized or owner of the property. If any of the party is not competent or capable of entering into the agreement, that agreement cannot be treated as a valid contract.

According to Section 11 of the Act which says that every person is competent to contract who is of the age of majority according to the law to which he is subject and who is of sound mind, and is not disqualified from contracting by any law to which he is subject. So it is clear that the party must be of sound mind and of age to enter into a valid agreement which can be treated as a valid contract.

Certainty of meaning: Wording of the agreement must be clear and not uncertain or vague. Suppose John agrees to sell 500 tones of oil to Mathew. But, what kind of oil is not mentioned clearly. So on the ground of uncertainty, this agreement stands void. If the meaning of the agreement can be made certain by the circumstances, it could be treated as a valid contract. For example, if John and Mathew are sole trader of coconut oil, the meaning of the agreement can be made certain by the circumstance and in that case, the agreement can be treated as a valid contract. According to Section 29 of the Contract Act says that Agreements, the meaning of which is not certain or capable of being made certain, are void.

Possibility of performance: As per section 56, if the act is impossible of performance, physically or legally, the agreement cannot be enforced by law. There must be possibility of performance of the agreement. Impossible agreements like one claims to run at a speed of 1000km/hour or Jump to a height of 100feet etc. would not create a valid agreement. All such acts which are impossible of performance would not create a valid contract and cannot treated as a valid contract. In essence, there must be possibility of performance must be there to create a valid contract.

Lawful consideration: An agreement must be supported by a consideration of something in return. That is, the agreement must be supported by some type of service or goods in return of money or goods. However, it is not necessary the price should be always in terms of money. It could be a service or another goods.

Example: Suppose X agrees to buy books from Y for $50. Here the consideration of X is books and the consideration of Y is $50. It can be a promise to act (doing something) or forbearance (not doing something). The consideration may be present, future or can be past. But the consideration must be real. For example If John agrees to sell his car of $ 50000 to Peter for $20000. This is a valid contract if John agrees to sell his car not under any influence or force. It can be valid only if the consideration of John is free. An agreement is valid only when the acts are legal. Illegal works like killing another for money, or immoral works or illegal acts are cannot be treated as a valid agreement. So, illegal works will not come under the contract act.

Legal formalities: The contract act does not insist that the agreement must be in writing, it could be oral. But, in some cases the laws strictly insist that the agreement must be in writing like agreement to sell immovable property must be in writing and should be registered under the Transfer of Property Act, 1882. These agreement are valid only when they fulfill the formalities like writing, registration, signing by the both the parties are completed. If these legal formalities are not completed, it cannot be treated as a valid contract.

These elements should be present in a contract to make it a valid contract. If any one of them is missing we cannot treat that agreement as a valid contract.

What is a Standard Form Contract?

Notes

A standard form contract is a document which is generally printed, containing terms and conditions, with certain blanks to be filled in. It is prepared by the business people. The customer has only to sign it. Therefore, from his standpoint, the freedom to contract is restricted. Many of the contracts now being entered into by consumers are not the result of individual negotiations; rather they are one-sided contracts. The consumer has to accept them or leave them. Rather than permit the form to be varied, the firm or industry imposing it simply refuses to deal with anyone who will not accept its terms. A contract thus is imposed by a party having a strong bargaining power on a party having a weak bargaining power. Hence, such a contract is known as a contract of adhesion. Most contracts for photocopier machines, insurance, automobiles, telephone, water and power connection and a host of other goods and services are contracts of adhesion. In fact, the process of dilution of the freedom of the parties to contract has started in a big way and a time might come when it shall only be a myth.

1.5 Illegal and Void Agreements

Sections 25 to 30 refer to cases in which the agreement is only void. Section 23 points out the cases where the consideration of an agreement is unlawful, and the agreement is also void. Thus, every illegal agreement is void, but every void agreement may not amount to illegal agreement.

An unenforceable contract is neither void nor voidable, but it cannot be enforced in the court because it lacks some item of evidence such as writing, registration or stamping or where the remedy has been barred by lapse of time. For instance, an agreement which is required to be stamped will be unenforceable if the same is not stamped at all or is understamped. In such a case, if the stamp is required merely for revenue purposes, as in the case of a receipt for payment of cash, the required stamp may be affixed on payment of penalty and the defect is then cured and the contract becomes enforceable. If, however, the technical defect cannot be cured the contract remains unenforceable, e.g., in the case of an unstamped bill of exchange or promissory note. In any case the contract may be carried out by the parties concerned; but in the event of breach or repudiation of such a contract, the aggrieved party shall not be entitled to the legal remedies.

1.6 Distinction between Void Agreement and Voidable Contract

The following points of distinction are worth noting:

1. ***Legality.*** A void agreement is without any legal effect and hence cannot be enforced by either party. A voidable contract, on the other hand, can be enforced by the party at whose option it is voidable.
2. ***Enforceability.*** A void agreement is unenforceable from the very beginning, whereas a voidable contract become unenforceable only when the party at whose option the contract is voidable' rescinds it.

Examples:

(i) A pays B ₹ 10,000 in consideration of B's promise to sell him some goods. The goods had been destroyed at the time of promise. The agreement is void and thus unenforceable.

(ii) A, a doctor, by exercising undue influence over his patient B induces him to sell his car worth ₹ 1,50,000 for ₹ 1,00,000. It is a voidable contract at the option of B. If B rescinds the contract, it becomes unenforceable; but if he does not, then the contract is enforceable.

3. ***Compensation.*** Under a voidable contract, any person who has received any benefit must compensate or restore it to the other party. The question of compensation in the event of non-performance of a void agreement does not arise, as it is unenforceable from the very beginning.

Notes

4. ***Effect on collateral transaction.*** A voidable contract does not affect collateral transaction. But if the agreement is void on account of the object or consideration being illegal or unlawful, the collateral agreement will also become void.

Obligation of the parties under a void contract and a voidable contract. In the case of a void contract, since the transaction is either unenforceable from the beginning or so becomes on the transaction becoming impossible or illegal of execution, the parties thereto are exonerated of their obligations. Thus, none of the parties can seek performance from the other. In the case of a voidable contract, the party aggrieved may or may not opt to repudiate the transaction. Thus, where it prefers, in spite of his consent being not free, to abide by the transaction the other party shall also be subject to the obligations contemplated under the contract. The position shall be as if the contract was a valid contract. But where it chooses to opt out of the transaction, then all the parties shall be excused from the obligations under the contract.

Are all unenforceable contracts void? Section 2(j) does not declare every unenforceable contract void. A contract may be unenforceable either by substantive law or by procedural law or regulation. It is only that contract which in unenforceable by substantive law which becomes void. In other words, 'unenforceable by law' means unenforceable by substantive law.

Examples:

(i) There is a contract with an alien enemy. It is illegal from its inception and therefore would be void under s.2(g).

(ii) There is a contract with an alien friend but later on he becomes an alien enemy. Such a contract would be void under s.2(j).

A contract may be unenforceable but not be void. Thus, a mere failure to sue within the time specified by the Limitation Act or an inability to sue by reason of the provisions of one of the orders under the Civil Procedure Code would not make the contract void.

Distinction between void agreement and void contract. A void agreement is unenforceable from the very beginning; whereas a void contract is valid at the time of its formation but becomes void later on.

Classification of contracts according to performance. Still another method of classifying contracts is in terms of the extent to which they have been performed. Accordingly, contracts may be: (i) Executed and executory, or (ii) Unilateral and bilateral. An executed contract is one which has been wholly performed. Nothing remains to be done in terms of the contract.

Example: A buys a bicycle from a dealer. A pays cash. The dealer delivers the bicycle.

An executory contract is one which remains wholly unperformed, or in which there remains something further to be done.

Example: On June 1, A enters into a contract with a dealer to buy a bicycle. The contract is to be performed on June 15.

The executory contract becomes an executed one when it is completely performed. For instance, in the above example, if both – A and the dealer perform their obligations on June 15, the contract becomes executed. However, if in terms of the contract performance of promise by one party is to precede performance by another party, then the contract is still executory, though it has been performed by one party.

Example: On June 1, A agrees to buy a bicycle from a dealer. The dealer has to deliver the bicycle on June 15 and A has to pay price on July 1. The dealer delivers the bicycle on June 15. The contract is executory as something remains to be done in terms of the contract.

Notes

A unilateral contract is one wherein at the time the contract is concluded there is an obligation to perform on the part of one party only.

Example: A makes payment for bus fare for his journey from Mumbai to Pune. He has performed his promise. It is now for the transport company to perform its promise.

A bilateral contract is one wherein there is an obligation on the part of both to do or to refrain from doing a particular thing. In this sense, bilateral contracts are similar to executory contracts.

An important corollary can be deduced from the distinction between executed and executory contracts, and between unilateral and bilateral contracts. It is that a contract is a contract from the time it is made and not from the time its performance is due. The performance of the contract can be made at the time when contract is made or it can be postponed either in full or in part.

Case Study

Robinson Contract

Robinson, a college football player, signed a contract on December 2 with the Detroit Lions, a pro football club. The contract was a standard form that contained a clause stating, "This agreement shall become valid and binding upon each party only when and if it shall be approved by the League Commissioner." In late December, Robinson informed the Detroit Lions that he would not be playing for them because he had signed on with the Dallas Cowboys. On January 12 the commisioner approved the contract. Detroit then sued Robinson for breach of contract.

Question

Was there ever a contract between Robinson and the Detroit Lions? Why or why not?

Answer

When Robinson signed the contract it was subject to the approval of the comissioner. This was an express condition precedent and by Robinson signing, he has an implied good faith effort to allow the commisioner the opportunity to accept. Robinson's power of revocation was temporarily suspended while he was waiting to be approved by the comissioner. His later revocation is considered a antipatory repudiation. Subsequently, when the commisioner approved the contract, it was binding and Robinson's repudiation can be considered a material breach by the Detroit Lions.

Source: http://www.askmehelpdesk.com/corporate-law/case-study-breach-contract-11531.html

1.7 Summary

- Mercantile Law may be defined as that branch of law which prescribes a set of rules for the governance of certain transactions and relations between: (i) business persons themselves, (ii) business persons and their customers, dealers, suppliers, etc., and (iii) business persons and the state.
- A business person can resort to various judicial and quasi-judicial authorities against the government in case his legal rights have been violated.
- The basic principle underlying law of contracts is that a stranger to a contract cannot maintain a suit for a remedy. The law entitles only those who are parties to the contract to file suits for exercising their rights. This is known as 'privity of contract'.

Notes

- There are different modes of formation of a contract. It may be made in writing or by word of mouth, or be inferred from the conduct of the parties or the circumstances of the case.
- An implied contract may be implied in fact or implied in law. Contracts implied in fact and contracts implied in law are not really contracts at all. They are remedies devised by the courts. Courts apply them when the legal requirements of Indian Contract Act, 1872 for contract formation do not exist, but it would be grossly unjust to permit one party to benefit – without paying – from what he received from the other.
- A contract implied at law, also called a quasi-contract, is an obligation imposed by a court to do justice between the parties even though they never exchanged, or intended to exchange, promises. In this instance, a court implies a contract to prevent one party's unjust enrichment at the other's expense.
- The contract act does not insist that the agreement must be in writing, it could be oral. But, in some cases the laws strictly insist that the agreement must be in writing like agreement to sell immovable property must be in writing and should be registered under the Transfer of Property Act, 1882. These agreement are valid only when they fulfill the formalities like writing, registration, signing by the both the parties are completed. If these legal formalities are not completed, it cannot be treated as a valid contract.
- These elements should be present in a contract to make it a valid contract. If any one of them is missing we cannot treat that agreement as a valid contract.

1.8 Keywords

Contract: It is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another.

Express contract: The terms of a contract may be stated in words (written or spoken).

Formal contract: It is one to which the law gives special effect because of the formalities or the special language used in creating it.

Illegal agreement: It is one that the courts will not enforce because the purpose is to achieve an illegal end.

Implied contract: It may be implied in fact or implied in law. Contracts implied in fact and contracts implied in law are not really contracts at all.

Legality: A void agreement is without any legal effect and hence cannot be enforced by either party.

Standard form Contract: It is a document which is generally printed, containing terms and conditions, with certain blanks to be filled in. It is prepared by the business people.

1.9 Self Assessment

Fill in the blanks:

1. An ..... may be implied in fact or implied in law. Contracts implied in fact and contracts implied in law are not really contracts at all.
2. A ..... is one which may be repudiated (i.e., avoided) at the will of one or more of the parties, but not by others.
3. An agreement which is not ..... by either of the parties to it is void ab initio such an agreement is without any legal effect.
4. An ..... is one that the courts will not enforce because the purpose is to achieve an illegal end.

State whether the following statements are true or false:

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5. According to Section 15 "All agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void".
6. The objective of the agreement must be lawful. Any act prohibited by law will not be valid and such agreements cannot be treated as a valid contract.
7. Section 24 to 30 specify certain types of agreement which have been expressly declared void.
8. An agreement must be supported by a consideration of something in return.

1.10 Review Questions

1. What is a contract? Why must you, as a manager, know as to what constitutes a contract?
2. What tests would you apply to ascertain whether an agreement is a contract?
3. Are there any essentials of a contract so as to make it enforceable by law?
4. "All agreements are not contracts but all contracts are agreements". Comment.
5. Explain what do you understand by 'void', 'voidable', 'illegal' and 'valid' contracts. Briefly refer to the rights of parties under such agreements.
6. Enumerate some of the contracts which are expressly declared to be void by the Indian Contract Act, 1872.
7. How safe are oral contracts?
8. "There are some contracts and documents which are required to be not only in writing and signed by the parties, but in addition, required to be registered with some competent authority or the other". Discuss.

Answers: Self Assessment

1.	implied contract	2.	voidable contract
3.	enforceable	4.	illegal agreement
5.	False	6.	True
7.	True	8.	True

1.11 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S .S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

Notes

Unit 2: Offer and Acceptance

CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss offer and acceptance
- Describe modes of making an offer
- Discuss acceptance of an offer

Introduction

In last unit you have studied about law of contact. As we come to know that a contract is an agreement, enforceable by law, made between at least two parties by which rights are acquired by one and obligations are created on the part of another. If the party, which had agreed to do something, fails to do that, then the other party has a remedy. The Act imparts definiteness in business transactions as it ensures that what a person has been led to expect shall come to pass and what has been promised to him shall be performed. Thus the purpose of the law of contract is to ensure the realisation of reasonable expectations of the parties who enter into a contract. This unit provides you significant understanding of offer and acceptance. This unit also discusses the concept of consideration.

2.1 Proposal (or Offer) and Acceptance [Ss. 3-9]

Notes

Offer is not only one of the essential elements of a contract but it is the basic building block also. An offer is synonymous with proposal. The offeror or proposer expresses his willingness "to do" or "not to do" (i.e., abstain from doing) something with a view to obtain acceptance of the other party to such act or abstinence [s.2 (a)]. Thus, there may be 'positive' or 'negative' acts which the offeror is willing to do.

Examples:

(i) Anna offers to sell her a book to Begum. Anna is making an offer to do something, i.e., to sell her a book. It is a positive act on the part of the offeror.

(ii) Amin offers not to file a suit against Bedi, if the latter pays Amin the amount of ₹ 10,000 outstanding. Here the act of Amin is a negative one i.e. he is offering to abstain from filing a suit.

An offer is made with a view to obtaining the assent of the offeree to the proposed act or abstinence.

Examples:

(i) Anna is making an offer to sell a book with a view to obtaining the assent of Begum.

(ii) Amin is making an offer to Bedi with a view to obtaining Bedi's assent thereto.

2.2 Modes of making an Offer

An offer can be made by any act or omission of party proposing by which he intends to communicate such proposal or which has the effect of communicating it to the other (s.3). An offer can be either express or implied, and specific or general.

Express offer. It means an offer made by words (whether written or oral). The written offer can be made by letters, telegrams, telex messages, advertisements, etc. The oral offer can be made either in person or over telephone.

Implied offer. It is an offer made by conduct. It is made by positive acts or signs so that the person acting or making signs means to say or convey something. However, silence of a party can, in no case, amounts to offer by conduct.

Offer by abstinence. An offer can also be made by a party by omission to do something. This includes such conduct or forbearance on one's part that the other person takes it as his willingness or assent.

Specific and general offers. An offer can be made either to (i) A definite person or a group of persons, or to (ii) the public at large. An offer made either to a definite person or a group of persons is a specific offer. The specific offer can be accepted by that person to whom it has been made. Thus, if a real estate company offers to sell a flat to Amar at a certain price, then it is only Amar who can accept it. The offer made to the public at large is a general offer. A general offer may be accepted by any one by complying with the terms of the offer. The celebrated case of *Carlill v Carbolic Smoke Ball Co.* (1813) 1 Q.B.256 is an excellent example of a general offer.

Example: A Patent Medicine company advertised that it would give a reward of £100 to anyone who contacted influenza after using smoke balls of the company for a certain period according to the printed directions. Mrs. Carlill purchased the advertised smoke ball and contacted influenza inspite of using the same according to the printed directions. She claimed the reward

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of £100. The company resisted the claim on the ground that advertisement was only an invitation to offer. They argued further that no offer was made to her, and that in any case she had not communicated her acceptance assuming the advertisement was an offer. She filed a suit for the recovery of the reward. Held that the advertisement in such type of cases amounted to general offers. She could recover the reward as she had accepted the offer by complying with the terms of the offer.

Philosophy underlying general offers. The general offer creates for the offeror a liability in favour of any person who happens to fulfill the conditions of the offer. It is not at all necessary for the offeree to be known to the offeror at the time. When the offer is made; he may be a stranger, but by complying with the conditions of the offer, he is deemed to have accepted the offer.

Implied offer. An offer, implied from the conduct of the parties or from the circumstances of the case, is known as implied offer.

Some examples of different types of offers.

1. A real estate company proposes, by a letter, to sell a flat to Rajiv at a certain price. This is an offer by an act by written words (i.e., letter). This is also known as an express offer.
2. If the company proposes, over telephone, to sell the flat to Rajiv at a certain price then this is an offer by an act (by oral words). This is an express offer.
3. A company owns a fleet of motor boats for taking people from Mumbai to Goa. The boats are in the waters at the Gateway of India. This is an offer by conduct to take passengers from Mumbai to Goa. Even if the incharge of the boat does not speak or call the passengers, the very fact that the motor boat is in the waters near Gateway of India signifies company's willingness to do an act with a view to obtaining the assent of other(s) (i.e., would-be passengers). This is an example of an implied offer.
4. Akbar, a creditor, offers not to file a suit against Begum, a debtor, if the latter pays him the amount of ₹ 2000 outstanding. This is an offer by abstinence or omission to do something.

2.3 Differences between Offer and Invitation to Offer

An offer is to be distinguished from an invitation to offer. A prospective shareholder by filling up a share application form, usually attached to the prospectus, is making the offer. An auctioneer at the time of auction inviting offers from the bidders is not making an offer. The price lists, catalogues and inviting tenders and quotations are mere invitations to offer. Likewise a display of goods with a price tag on them in a shop window is construed an invitation to offer and not an offer to sell.

Example: In a departmental store, there is self-service. The customers pick up articles and take to the cashier's desk to pay. The customer's action in picking up a particular article is an offer to buy. As soon as the cashier accepts payment, a contract is entered into. However, there are certain exceptions to this. Thus, where a store advertises that it will give a free gift or a special discount to "the first 100 customers" or something like that, it may be anything that requires special effort on the part of the customer. If so, the store has made an offer which he may accept by being among the 100 customers. Similarly, sale promotion schemes requiring customers to do anything special are offers.

2.4 Essentials of a Valid Offer

1. ***The terms of the offer must be definite, unambiguous and certain or capable of being made certain.*** If the terms of the offer are loose, vague, ambiguous or uncertain, it is not a valid offer.

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2. ***An offeree must have knowledge of the offer before he can accept it.*** The offer must be communicated to the other party. The communication of offer is complete only when it comes to the knowledge of the offeree. If the offer is lost on the way in transit it is no offer. This is true of specific as well as general offers.

3. ***An offer cannot contain a term the non-compliance of which may be assumed to amount to acceptance.*** An offeror cannot say that if the offeree does not accept the offer within two days the offer would be deemed to have been accepted. Such a burden cannot be imposed on the offeree. It is for the offeree to accept the offer or not; and therefore, he may communicate his acceptance accordingly.

4. ***If a person makes a statement without any intention of creating a binding obligation this does not amount to an offer.*** It is only a mere declaration of intention to offer.

Example: An auctioneer, L, advertised that a sale of office furniture would take place at a particular place on a stated day. H travelled down about 100 km. to attend the sale but found the furniture was withdrawn from the sale. He claimed compensation from the auctioneer. Held, that auctioneer was not liable.

5. Where two parties make identical offers to each other in ignorance of each other's offer this does not result in a contract. Such offers are known as cross offers and neither of the two can be called an acceptance of the other.

6. The offer must be made with a view to obtain acceptance thereto.

7. The offer must be made with the intention of creating legal relationship. An offer of a purely social or domestic nature is not a valid offer.

8. The offer must be communicated to the offeree before it can be accepted. This is true of both specific and general offers.

9. If no time is fixed by the offeror within which the offer is to be accepted, the offer does not remain open for an indefinite period. Where no time is specified, then the offer is to be accepted within a reasonable time. Thus, if no time is specified then the offer lapses after a reasonable time. What is a reasonable time is a question of fact and would depend upon the circumstances of each case.

10. An offer must be distinguished from a mere invitation to offer.

Irrevocable offers. Generally, a proposer specifies a period within which the offeree must accept. Thus, if A makes an offer to B on 1 June, valid upto 6 June, but revokes it on 5 June, before its acceptance by B the revocation is effective, and the offeree has no remedy. However, the courts will bind an offeror to his promise to hold an offer open in exchange for a consideration given by the offeree. For instance, in the above case, if B had given some consideration to A to keep the offer open, then A could not revoke the same before the specified time. Sometimes such contracts are called "option contracts".

Task Discuss Irrevocable offer by giving relevant example.

2.5 Revocation of Offer

There are many reasons due to which the offer lapses or is revoked such as: (i) An offer is revoked by the death or insanity of the proposer, if the fact of his death or insanity comes to the knowledge of the acceptor before acceptance. Therefore, if the acceptance is made in ignorance of the death, or insanity of the offeror, there would be a valid contract, (ii) An offer lapses by the death or

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insanity of the offeree before acceptance, (iii) An offer terminates when rejected by the offeror, (iv) An offer terminates when revoked by the offeror before acceptance by the offeree, (v) An offer terminates by not being accepted in the mode prescribed, or if no mode is prescribed, in some usual and reasonable mode (or manner), (vi) A conditional offer terminates when the condition is not accepted by the offeree, (vii) An offer terminates by counter-offer by the offeree.

Meaning of a Counter-offer

When in place of accepting the terms of an offer as they are, the offeree accepts the same subject to certain conditions or qualifications, he is said to make a counter offer.

Example: An offer to sell rice was accepted by the offeree with an endorsement on the Sold and Bought Notes that yellow and wet grain will not be accepted [*Ali Shain v. Moothia Chetti,* 2 Bom L R 556]. Held, there was no contract.

Special Terms in a Contract

Many times, there are certain special terms, which form part of the offer, but they are not duly brought to the notice of the offeree (i.e., consumer or a customer or a client), at the time the offer is made. If these special terms are not brought to the customer's notice, then there is no valid offer. In case the offer is accepted, and the contract is formed, the customer is not bound by the special terms. The terms may be brought to the customer's notice either (i) by drawing his attention to them specifically or (ii) by inferring that a man of ordinary prudence could find them by exercising ordinary diligence.

The examples of the first case are where certain conditions are written on the back of a ticket for a journey or deposit of luggage in a cloak room and the words, "For conditions see back" are printed on the face of it. In such cases, the acceptor, i.e., the person buying the ticket is bound by whatever conditions are written on the back of the ticket whether he has read them or not.

An example of the second case is where the conditions forming part of the offer are printed in a language not understood by the offeree but his attention has been drawn to them in a reasonable manner. In such a case, the law imposes an obligation upon the offeree to ask for the translation of the conditions. If he fails to do so, it is presumed that he has constructive notice of these special terms and he will be bound by them.

However, if the special conditions forming part of an offer are contained in a document which is delivered after the contract is complete, then the customer is not bound by them. Such a document is considered a non-contractual document as it is not supposed to contain the conditions of the contract.

Task

Give examples related to counter-offer.

2.6 Acceptance of an Offer

When the person to whom the offer is made signifies his assent thereto, the offer is said to be accepted [s.2(b)]. Thus, acceptance is the act of giving consent to the proposal. The offeree is deemed to have given his acceptance when he gives his assent to the proposal. The acceptance of an offer may be express or implied. It is express when the acceptance has been signified either in writing or by words of mouth or by performance of some required act of the offeree. The acceptance by performing the required act may be exemplified with reference to *Carlill v. Carbolic Smoke Ball Co.* case (supra).

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Example:

(i) A shopkeeper received an order from a customer – a household lady. He executed the order by sending the goods. The customer's order for goods constitutes the offer which was accepted by the shopkeeper by sending the goods. It is a case of acceptance by conduct. Here the shopkeeper is accepting the offer by the performance of the act (i.e., sending the goods).

(ii) A loses his dog and announces a reward of ₹ 500 to anyone who brings his dog to him. B need not convey his acceptance of the offer, which is a general one. If he finds the dog and gives it to A, he is entitled to the reward as he accepted the offer by doing the required act.

Implied acceptance. Acceptance is implied when it is said to be gathered from the surrounding circumstances or the conduct of the parties.

Example:

(i) A enters into a bus for going to his destination and takes a seat. From the very nature of the circumstance the law will imply acceptance on the part of A.

(ii) A's scooter goes out of order and he is stranded on a lonely road. B, mechanic who observes this starts correcting the fault. A allows B to do the same. From the nature of the circumstances A has given his acceptance to the offer of B.

Who can accept an offer. We have mentioned earlier that a specific offer can be accepted only by the person to whom it is made. The rule of law is that if A wants to enter into a contract with B then C cannot substitute himself for B without A's consent. However in the case of a general offer it can be accepted by anyone by complying with the terms of the offer.

Example:

(i) A purchased B's business. Prior to the purchase, A was working as the manager of B. C, to whom B owed a debt, placed an order with the latter for the supply of certain goods. A supplied the goods even though the order was not addressed to him. C refused to pay A for the goods because he, by entering into contract with B, intended to set-off his debt against B. Held, the offer could be accepted by B only and not by anyone else. [*Boulton v. Jones* 157 ER 232].

(ii) The case of *Carlill v. Carbolic Smoke Ball Co.* (Supra) illustrates that a general offer can be accepted by anyone by complying with the requirements of the offer.

Essentials of a valid acceptance. The following are the essentials of a valid acceptance:

(i) It must be absolute and unqualified and according to the exact terms of the offer (s.7),

(ii) It must be communicated to the offeror,

(iii) It must be according to the mode, if any, prescribed by the offeror (s.7),

(iv) It must be given within the time specified, if any, otherwise it must be given within a reasonable time,

(v) It must be made before the offer lapses or is terminated, revoked or withdrawn. If the offer has already lapsed then there is nothing to accept,

(vi) It must be given by the person to whom the offer is made. However, in the case of a general offer, acceptance can be given by any member of the public.

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Meaning of the phrase "acceptance must be absolute and unqualified". Acceptance must be according to the exact terms of the offer. An acceptance with a variation however slight is no acceptance and may amount to a mere counter offer which the original offeror may or may not accept. A, a furniture maker, offers to sell B, a dining table for ₹ 2,000. B replied, "I can pay ₹ 1,800 for it". The offer of A is rejected by B as the acceptance is qualified. However, B subsequently changes his mind and is prepared to pay ₹ 2,000. This also will be treated as a counter offer and it is up to A to accept the same or not.

Example:

(i) A offered to sell his land to B for ₹ 50,000. B replied purporting to accept and enclosed ₹ 10,000 promising to pay the balance of ₹ 40,000 by monthly installments of ₹ 5,000 each. Held, that B could not enforce acceptance because his acceptance was not unqualified.

(ii) A offers to sell his house to B for ₹ 5,00,000. B replies, "I am prepared to buy your house for ₹ 5,00,000 provided you purchase my Maruti Car for ₹ 2,00,000". There is no acceptance on the part of B.

However, if some conditions are implied as a part of the contract and the offeree accepts the offer subject to those conditions the acceptance will be treated as valid.

Example: A, a real estate company, offers to sell a flat to B and B agrees to purchase it subject to the title to the flat being approved by B's solicitor. The acceptance by B is absolute and not qualified as it is presumed that A has a title to the property and it was not necessary for A to mention anything about the title.

Acceptance of an offer "subject to a contract" or "Subject to a formal contract", or 'Subject to a contract to be approved by solicitors" – The significance of these words is that the parties do not intend to be bound and are not bound until a formal contract is prepared and signed by them. The acceptor may agree to all the terms of the offer and yet decline to be bound until formal agreement is drawn up.

Example:

(i) C accepted E's offer to sell four items of antique furniture for ₹ 44,000 subject to a proper contract to be prepared by the vendor's solicitors. A contract was prepared by C's solicitors and approved by E's solicitors but E refused to sign it. Held, there was no contract as the agreement was only conditional [*Chillingworth v. Esche* (1924) 1 Ch.97].

(ii) E bought a flat from a real estate company "subject to a contract". The terms of the formal contract were agreed and each party signed his part. E posted his part but the company did not post its part as it changed its mind in the meantime. Held, that there was no binding contract between the parties [*Eccles v. Bryant* (1948) Ch. 93].

A mere mental acceptance is no acceptance. Acceptance must be communicated to the offeror. The communication of acceptance may be express or implied. A mere mental acceptance is no acceptance. A mere mental acceptance means that the offeree is assenting to an offer in his mind only and therefore there is no communication of acceptance to the offeror.

Example: A, a supplier, sent a draft agreement relating to the supply of coal and coke to the manager of a railway company for his acceptance. The manager wrote the word 'approved' on the same and put the draft in the drawer of his table intending to send it to the company's solicitors for a formal contract to be drawn up. By an oversight, the draft agreement remained in the drawer. Held, there was no contract as the manager had not communicated his acceptance to the proposer.

Notes

Effect of silence of the offeree or his failure to reply. The acceptance of an offer cannot be implied from the silence of the offeree or his failure to reply.

Example: A offered by a letter to buy his nephew's T.V. set for ₹ 3,000, saying, "If I hear no more from you, I shall consider the T.V. set is mine at ₹ 3,000". The nephew did not reply at all, but he told an auctioneer who was selling his T.V. set, not to sell that particular T.V. set as he had sold it to his uncle. By mistake, the auctioneer sold the set. A sued the auctioneer for conversion. Held, A could not succeed as his nephew had not communicated acceptance and therefore there was no contract. However, if the offeree has by his previous conduct indicated that his silence means that he accepts then the acceptance of the offer can be implied from the silence of the offeree. Further, in the case of a general offer it is not necessary to communicate the acceptance if it is made by acting upon the terms of the offer [*Carlill v. Carbolic Smoke Ball Co.*, Supra].

Acceptance must be according to the mode prescribed [s.7]. Where the offeror prescribes a particular mode of acceptance then the acceptor should follow that mode. In case no mode of acceptance is prescribed by the offeror, then the acceptance must be according to some usual and reasonable mode. If the offeror prescribes a manner in which the offer is to be accepted and the acceptance is not made in such manner, the offeror may, within a reasonable time, after the acceptance is communicated to him, insist that his offer shall be accepted in the prescribed mode and not otherwise, but if he fails to do so he is deemed to have agreed to the acceptance.

Example: A sends an offer to B through post in the usual course. B should make the acceptance in the "usual and reasonable manner" as no mode of acceptance is prescribed. He may accept the offer by sending a letter through post in the ordinary course within a reasonable time. However, if A had asked for an acceptance by telegram then B should accept the offer by telegram. In case B accepts the offer by a letter then A may insist that the acceptance should be in the prescribed mode. But if A (the offeror) does not insist within a reasonable time that the acceptance be in the prescribed mode, then he is bound by the acceptance though not made in the prescribed mode.

An agreement to agree in the future (futuristic agreements). Law does not allow making of an agreement to agree in the future. The parties must agree on terms of the agreement. The terms of the agreement must be either definite or capable of being made definite without further agreement of the parties.

2.7 Completion of Communication of Offer and Acceptance [S. 4]

It is necessary to communicate offer to the offeree and the acceptance to the offeror. When is it that the communication is considered to be completed? The communication of an offer is complete when it comes to the knowledge of the person to whom it is made. Where A proposes by a letter to sell his car to B at a certain price, the communication of the offer is complete when B receives the letter. The completion of communication of acceptance has two aspects, viz; (i) As against the offeror and (ii) As against the acceptor. The communication of acceptance is complete (i) As against the offeror when it is put into a course of transmission to him so as to be out of the power of the acceptor; (ii) As against the acceptor, when it comes to the knowledge of the offeror. Thus, in the above example, if B accepts A's offer by sending a letter through post, then the communication of acceptance is complete (i) As against A when the letter is posted by B; and (ii) As against B when the letter is received by A.

Revocation of offer and acceptance [s.5]. It is possible for the offeror to revoke the offer before it is accepted by the offeree but not later. Similarly, the offeree may revoke acceptance, till the communication of acceptance is complete as against him but not later. Thus, in the above example A may revoke his offer at any time before or at the moment, when B posts his letter of acceptance, but not afterwards. B may revoke his acceptance at any time before or at the moment when

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the letter communicating it reaches A, but not afterwards. The communication of a revocation (of an offer or an acceptance) is complete (i) As against the person who makes it when it is put into a course of transmission to the person to whom it is made so as to be out of the power of the person who makes it; (ii) As against the person to whom it is made, when it comes to his knowledge. In the above example, A may revoke his offer by telegram. The revocation is complete (i) As against A when the telegram is dispatched; (ii) As against B when B receives it. B may revoke his acceptance by a telegram. B's revocation is complete as against B, when the telegram is dispatched, and as against A when it reaches him.

Contracts over telephone or through telex, fax/e-mail. One may enter into contracts either (i) When he is face to face with another person or (ii) Over telephone or (iii) through telex or (iv) through post office. When one is face to face with another person, the contract comes into existence immediately after the negotiations are completed with the process of offer and acceptance. Contracts over telephone are just like contracts face to face. But the offeree must make it sure that his acceptance is received by the offeror otherwise there will be no contract, as communication of acceptance is not complete.

2.8 Contingent Contract Defined (S. 31)

A contingent contract is a contract to do or not to do something, if some event, collateral to such contract does or does not happen.

Example: A contracts to pay B ₹ 10,000 if B's house is burnt. This is a contingent contract.

Essential Characteristics of a Contingent Contract

1. The performance of a contingent contract depends upon happening or non-happening of some future event.
2. The event on which the performance is made to depend, is an event collateral to the contract, i.e. it does not form part of the reciprocal promises which constitute the contract.

Example:

(i) A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards, the contract is a conditional contract and not contingent, because the event on which B's obligation is made to depend is a part of the promise itself and not a collateral event.

(ii) A promises to pay B ₹ 10,000 if he marries C, it is not a contingent contract.

3. The contingent event should not be the mere will of the promisor.

Example: A promises to pay B ₹ 1,000, if he so chooses, it is not a contingent contract.

However, where the event is within the promisor's will but not merely his will, it may be a contingent contract.

Example: A promises to pay B ₹ 1,000, if A left Delhi for Mumbai, it is a contingent contract, because going to Mumbai is an event within A's will, but is not merely his will.

Rules Regarding Enforcement of Contingent Contracts (Ss. 32 to 36). The rules regarding contingent contracts are summarised hereunder:

1. Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened. And if the event becomes impossible such contract becomes void (s.32).

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Example:

(i) A makes a contract with B to buy B's house if A survives C. This contract cannot be enforced by law unless and until C dies in A's lifetime.

(ii) A makes a contract with B to sell a house to B at a specified price if C, to whom the house has been offered, refuses to buy it. The contract cannot be enforced by law unless and until C refuses to buy the house.

(iii) A contracts to pay B a sum of money when B marries C. C dies without being married to B. The contract becomes void.

2. Contingent contract to do or not to do anything if an uncertain future event happens can be enforced when the happening of that event becomes impossible, and not before (s.33).

Example: A agrees to pay B a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

3. If a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies (s.34).

Example: A agrees to pay B a sum of money if B marries C. C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die and C may afterwards marry B.

4. Contracts contingent upon the happening of a specified uncertain event within a fixed time become void if, at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible (s.35 para 1).

Example: A promises to pay B a sum of money if a certain ship returns within an year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is destroyed within the year.

5. Contracts contingent upon the non happening of a specified event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened, or, before the time fixed expired, if it becomes certain that such event will not happen (s.35 para II).

Example: A promises to pay B a sum of money if a certain ship does not return within an year. The contract may be enforced if the ship does not return within the year, or is destroyed within the year.

6. Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility of the event is known or not to the parties to the agreement at the time when it is made.

Example:

(i) A agrees to pay B ₹ 1,000 if two parallel straight lines should enclose a space. The agreement is void.

(ii) A agrees to pay B ₹ 1,000 if B will marry A's daughter C. C was dead at the time of the agreement. The agreement is void.

Notes

2.8.1 Quasi Contracts (Ss.68-72) (Certain Relations Resembling those created by Contracts)

Meaning of Quasi Contracts

'Quasi Contracts' are so-called because the obligations associated with such transactions could neither be referred as tortuous nor contractual, but are still recognized as enforceable like contracts, in courts. According to Dr Jenks, quasi contract is "a situation in which law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract, express or implied, has in fact been entered into by them". The principle underlying a quasi contract is that no one shall be allowed unjustly to enrich himself at the expense of another, and the claim based on a quasi-contract is generally for money.

Example: X supplies goods to his customer Y who receives and consumes them. Y is bound to pay the price. Y's acceptance of the goods constitutes an implied promise to pay. This kind of contract is called a tacit contract. In this very illustration, if the goods are delivered by a servant of X to Z, mistaking Z for Y, then Z will be bound to pay compensation to X for their value. This is a quasi contract.

2.8.2 Cases which are treated as Quasi Contracts

Following are the cases which are to be deemed quasi contracts:

1. ***Claim for necessaries supplied to a person incapable of contracting or on his account.*** If a person, incapable of entering into a contract, or any one whom he is legally bound to support is supplied by another person with necessaries suited to his condition in life, the person who furnished such supplies is entitled to be reimbursed from the property of such incapable person (s.68).

Example:

(i) A supplies B, a lunatic, with necessaries suitable to his condition in life. A is entitled to be reimbursed from B's property.

(ii) A who supplies the wife and children of B, a lunatic, with necessaries suitable to their conditions in life, is entitled to be reimbursed from B's property.

The above section covers the case of necessaries supplied to a person incapable of contracting (say, a minor, lunatic, etc.) and to persons whom the incapable person is bound to support (e.g., his wife and minor children). However, following points should be carefully noted: (a) The goods supplied must be necessaries. What will constitute necessaries shall vary from person to person depending upon the social status he enjoys. (b) It is only the property of the incapable person that shall be liable. He cannot be held liable personally. Thus, where he doesn't own any property, nothing shall be payable.

2. ***Reimbursement to a person paying money due by another in payment of which he is interested.*** A person who is interested in the payment of money which another is bound by law to pay, and who, therefore, pays it, is entitled to be reimbursed by the other. (s.69).

Example: B holds land in Bengal, on a lease granted by A, the Zamindar. The revenue payable by A to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue Law, the consequence of such sale will be the annulment of B's lease. B, to prevent the sale and the consequent annulment of his own lease, pays the Government, the sum due from A. A is bound to make good to B the amount so paid.

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In order that the Section may apply, it is necessary to prove that: (a) The person making the payment is interested in the payment of money, i.e. the payment was made bona fide, for the protection of his own interest. (b) The payment should not be a voluntary payment. It should be such that there is some legal or other coercive process compelling the payment. (c) The payment must be to another person. (d) The payment must be one which the other party was bound by law to pay.

3. ***Obligation of a person enjoying benefits of non-gratuitous act.*** Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore the thing so done or delivered [s.70].

Example:

(i) A, a tradesman, leaves goods at B's house by mistake. B treats the goods his own. He is bound to pay for them.

(ii) A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

In order that s. 70 may apply, the following conditions must be satisfied:

(a) the thing must be done lawfully;

(b) the intention must be to do it non-gratuitously; and

(c) the person for whom the act is done must enjoy the benefit of it.

4. ***Responsibility of finder of goods.*** Ordinarily speaking, a person is not bound to take care of goods belonging to another, left on a road or other public place by accident or inadvertence, but if he takes them into his custody, an agreement is implied by law. Although, there is in fact no agreement between the owner and the finder of the goods, the finder is, for certain purposes, deemed in law to be a bailee and must take as much care of the goods as a man of ordinary prudence would take of similar goods of his own. This obligation is imposed on the basis of a quasi contract. Section 71, which deals with this subject, says: "A person who finds good belonging to another and takes them into his custody, is subject to the same responsibility as a bailee".

5. ***Liability of a person to whom money is paid, or thing delivered by mistake or under coercion (s.72).*** A person to whom money has been paid, or thing delivered by mistake or under coercion, must repay or return it.

Example:

(i) A and B jointly owe ₹ 1,000 to C. A pays the amount to C. Also, B, not knowing this fact, pays ₹ 1,000 to C. C is bound to repay the amount to B.

(ii) A railway company refuses to deliver up certain goods to the consignee except upon the payment of an illegal charge for carriage. The consignee pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

The term mistake as used in s. 72 includes not only a mistake of fact but also a mistake of law. There is no conflict between the provisions of s. 72 on the one hand and Ss. 21 and 22 on the other. If one party under mistake, whether of fact or law, pays to another party money which is not due by contract or otherwise, that money must be repaid [*Sales Tax Officer, Benares v. Kanhaiyalal Makanlal Saraf*, (1959) S.C.J.53].

Notes

2.8.3 Quantum Meruit

The phrase 'quantum meruit' means 'as much as merited' or 'as much as earned'. The general rule of law is that unless a person has performed his obligations in full, he cannot claim performance from the other. But in certain cases, when a person has done some work under a contract, and other party repudiated the contract, or some event happens which makes the further performance of the contract impossible, then the party who has performed the work can claim remuneration for the work he has already done. The right to claim quantum meruit does not arise out of the contract as the right to damages does; it is a claim on the quasi-contractual obligation which the law implies in the circumstances [*Patel Engg. Co. Ltd v. Indian Oil Corporation Ltd*, AIR (1975) Pat. 212].

The claim on 'quantum meruit' arises in the following cases:

1. ***When a contract is discovered to be unenforceable (s.65).*** When an agreement is discovered to be void or becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from he received it.

Example:

(i) A pays B ₹ 1,000 in consideration of B's promising to deliver his dog. The dog is dead at the time of the promise. The agreement is void, but B must repay A the 1,000 rupees.

(ii) A contracts with B to deliver to him 250 kilos of rice before the 1st of May. A delivers 130 kilos only before that day and none after. B retains the 130 kilos after the 1st of May. He is bound to pay A for them.

(iii) A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights every week during the next two months, and B engages to pay her ₹ 100 for each night's performance. On the sixth night, A willfully absents herself from the theatre and B, in consequence, rescinds the contract. B must pay A for the five nights on which she had sung.

2. ***When one party abandons or refuses to perform the contract.*** Where there is a breach of contract, the aggrieved party is entitled to claim reasonable compensation for what he has done under the contract.

Example: C, an owner of a magazine, engaged P to write a book to be published in installments in his magazine. After a few installments were published, the magazine was abandoned. Held, P could claim payment on quantum meruit for the part already published [*Planche v. Colburn* (1831) 8 Bing. 14].

3. When a contract is divisible and the party not in default, has enjoyed the benefit of the part performance, the party in default may sue on quantum meruit.

4. ***When an indivisible contract is completely but badly performed.*** When an indivisible contract for a lumpsum is completely performed, but badly, the person who has performed can claim the lump sum less deduction for bad work.

Example: A agreed to decorate B's flat for a lumpsum of ₹ 750. A did the work but B complained for faulty workmanship. It cost B ₹ 204 to remedy the defect. Held, A could recover from B ₹ 750 less ₹ 204 [*Hoening v. Isaacs* (1952) AIR 11 E.R. 176].

2.9 Summary

Notes

- Offer is not only one of the essential elements of a contract but it is the basic building block also. An offer is synonymous with proposal. The offeror or proposer expresses his willingness "to do" or "not to do" (i.e., abstain from doing) something with a view to obtain acceptance of the other party to such act or abstinence [s.2 (a)]. Thus, there may be 'positive' or 'negative' acts which the offeror is willing to do.
- If the terms of the offer are loose, vague, ambiguous or uncertain, it is not a valid offer.
- The communication of offer is complete only when it comes to the knowledge of the offeree. If the offer is lost on the way in transit it is no offer. This is true of specific as well as general offers.
- The offer must be made with a view to obtain acceptance thereto.
- The offer must be made with the intention of creating legal relationship. An offer of a purely social or domestic nature is not a valid offer.
- The offer must be communicated to the offeree before it can be accepted. This is true of both specific and general offers.
- If no time is fixed by the offeror within which the offer is to be accepted, the offer does not remain open for an indefinite period. Where no time is specified, then the offer is to be accepted within a reasonable time. Thus, if no time is specified then the offer lapses after a reasonable time. What is a reasonable time is a question of fact and would depend upon the circumstances of each case.
- Acceptance of an offer "subject to a contract" or "Subject to a formal contract", or 'Subject to a contract to be approved by solicitors" – The significance of these words is that the parties do not intend to be bound and are not bound until a formal contract is prepared and signed by them. The acceptor may agree to all the terms of the offer and yet decline to be bound until formal agreement is drawn up.
- The acceptance of an offer cannot be implied from the silence of the offeree or his failure to reply.
- When one party abandons or refuses to perform the contract. Where there is a breach of contract, the aggrieved party is entitled to claim reasonable compensation for what he has done under the contract.
- When a contract is divisible and the party not in default, has enjoyed the benefit of the part performance, the party in default may sue on quantum meruit.
- When an indivisible contract is completely but badly performed. When an indivisible contract for a lumpsum is completely performed, but badly, the person who has performed can claim the lump sum less deduction for bad work.

2.10 Keywords

Express offer: It means an offer made by words (whether written or oral). The written offer can be made by letters, telegrams, telex messages, advertisements, etc. The oral offer can be made either in person or over telephone.

Implied offer: It is an offer made by conduct. It is made by positive acts or signs so that the person acting or making signs means to say or convey something. However, silence of a party can, in no case, amounts to offer by conduct.

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Offer by abstinence: An offer can also be made by a party by omission to do something. This includes such conduct or forbearance on one's part that the other person takes it as his willingness or assent.

Specific and general offers: An offer can be made either to (i) A definite person or a group of persons, or to (ii) the public at large.

2.11 Self Assessment

Fill in the blanks:

1. An offer, ... from the conduct of the parties or from the circumstances of the case, is known as implied offer.
2. A ..... by filling up a share application form, usually attached to the prospectus, is making the offer.
3. ..... is implied when it is said to be gathered from the surrounding circumstances or the conduct of the parties.
4. The acceptor may agree to all the terms of the offer and yet ..... to be bound until formal agreement is drawn up.
5. The performance of a ..... depends upon happening or non-happening of some future event.
6. ..... are so-called because the obligations associated with such transactions could neither be referred as tortuous nor contractual, but are still recognized as enforceable like contracts, in courts.
7. The principle underlying a quasi contract is that no one shall be allowed unjustly to enrich himself at the expense of another, and the ..... based on a quasi-contract is generally for money.
8. A person who is interested in the ..... which another is bound by law to pay, and who, therefore, pays it, is entitled to be reimbursed by the other.
9. Obligation of a person enjoying benefits of ..... act.
10. The phrase ..... means 'as much as merited' or 'as much as earned'.

2.12 Review Questions

1. Define offer and distinguish between offer and invitation to offer.
2. (i) How is an offer made? (ii) Explain an implied offer, a specific offer, a general offer, a counter-offer?
3. If the special conditions forming part of an offer are contained in a document which is delivered after the contract is complete, is the other party (say a customer) bound by them?
4. What are the reasons due to which the offer lapses or is revoked? If no time is fixed by the offeror within which the offer is to be accepted does the offer remain open for an indefinite period of time?
5. (i) When is an offer said to be accepted? (ii) In which way acceptance of offer may be made?

6. Comment: (i) "Acceptance must be absolute and qualified"? (ii) "A mere mental acceptance is no acceptance". (iii) "Acceptance must be according to the mode prescribed by the offeror"? (iv) "A mere mental acceptance not evidenced by words or conduct is in the eye of law no acceptance".

Notes

7. Discuss the rules regarding communication of offer and acceptance.
8. "A stranger to a contract cannot maintain a suit". Discuss.

Answers: Self Assessment

1.	implied	2.	prospective shareholder
3.	Acceptance	4.	decline
5.	contingent contract	6.	'Quasi Contracts'
7.	claim	8.	payment of money
9.	non-gratuitous	10.	'quantum meruit'

2.13 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S .S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

Notes

Unit 3: Capacity to Contract

CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss capacity to contract
- Describe the meaning of consideration
- Discuss agreement declared void

Introduction

In last unit you have studied about offer, acceptance and consideration. The offer made to the public at large is a general offer. A general offer may be accepted by any one by complying with the terms of the offer. As you all know that acceptance is the act of giving consent to the proposal. The offeree is deemed to have given his acceptance when he gives his assent to the proposal. The acceptance of an offer may be express or implied. It is express when the acceptance has been

signified either in writing or by words of mouth or by performance of some required act of the offeree. This unit provides you a brief description of capacity to contract.

Notes

3.1 Capacity to Contract (Ss. 10-12)

3.1.1 Persons who are Competent to Contract

Any one cannot enter into a contract; he must be competent to contract according to the law. Every person is competent to contract if he (i) is of the age of majority, (ii) is of sound mind, and (iii) is not disqualified from contracting by any law to which he is subject (s.11). Thus, there may be a flaw in the capacity of parties to the contract. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness, drug addiction or status. If a party to a contract suffers from any of these flaws the contract may not be a valid one. If the contract would have been allowed to be a valid one then it would result in one party being at a disadvantage in the bargaining process.

3.1.2 Capacity of a Minor to enter into a Contract

Age of a person determines enough maturity to make a contract. The contract law defines maturity as the age of majority. That usually is 18 years. Does this mean that a minor is not competent to contract? No, a minor may make a contract, but he is not bound by the contract; however the minor can make the other party bound by the contract. Thus, a minor is not bound on a mortgage or a promissory note, but he can be a mortgagee, a payee, or an endorsee. He can derive benefit under the contract. However, an agreement with a minor cannot be ratified by him on his attaining majority so as to make himself bound by the same. Further, if he has received any benefit under the contract, the minor cannot be asked to refund the same. In fact he is always allowed to plead minority and is not stopped to do so even where he had procured a loan or entered into some other contract by falsely representing that he was of full age. It is to be noted that if money lent to him or an item sold to him could be traced then the court may, on equitable grounds, ask the minor to return the same to the lender or the seller, as the case may be as a minor does not have the liberty to cheat. In the case of a fraudulent misrepresentation of his age by the minor, inducing the other party to enter into a contract, the court may award compensation to the other party under Ss.30 and 33 of the Specific Relief Act, 1963.

Further, a minor cannot be a partner in a partnership firm. However, he may with the consent of all the partners for the time being, be admitted to the benefits of partnership (s.36, the Indian Partnership Act, 1932). Also, a minor can act as an agent and bind his principal by his acts without incurring any personal liability.

Section 68 provides that a minor's estate is liable to a person who supplies necessaries of life to a minor, or to one whom the minor is legally bound to support, according to his station in life, not on the basis of any contract, but on the basis of an obligation resembling a contract. However, there is no personal liability of a minor for the necessaries of life supplied. The definition of a "necessary of life" depends entirely on the person and the situation. It probably will always include food and probably will never include a car. In order to entitle the supplier to be reimbursed from the minor's estate, the following must be satisfied:

(i) The goods are 'necessaries', for that particular minor having regard to his conditions in life (or status or standard of living) and that purchase or hire of a car may be 'necessary' for a particular minor;

(ii) The minor needs the goods both at the time of sale and delivery. What is necessary to see is the minor's actual requirements at the time of sale and at the time of delivery, where these are different.

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A minor's estate is liable not only for the necessary goods but also for the necessary services rendered to him. The lending of money to a minor for the purpose of defending a suit on behalf of a minor in which his property is in jeopardy, or for defending him in prosecution, or for saving his property from sale in execution of a decree is deemed to be a service rendered to the minor. Other examples of necessary services rendered to a minor are: provision of education, medical and legal advice, provision of a house on rent to a minor for the purpose of living and continuing his studies.

A minor's parents/guardians are not liable to his creditors for the breach of a contract by him whether the contract is for necessaries of life or not. However, the parents would be liable where the minor is acting as their agent.

The position of minors contract may be summed up as follows:

1. A contract with a minor is void, and a minor, therefore cannot bind himself by a contract. A minor is not competent to contract. In *Mohiri Bibi v. Dharmodas Ghosh* the facts were as follows:

   Dharmodas Ghosh, a minor, entered into a contract for borrowing a sum of ₹ 20,000 out of which the lender paid the minor a sum of ₹ 8000. The minor executed a mortgage of his property in favour of the lender. Subsequently, the minor sued for setting aside the mortgage, the court ordered for setting aside the mortgaged. The mortgagee, prayed for refund of ₹ 8000 by the minor. Held, further that as a minor's contract is void, any money advanced to a minor cannot he recovered.

2. A minor can be a promisee or a beneficiary: During his minority, a minor cannot bind himself by a contract, but he may enforce a contract for his benefit. Thus, a minor is incapable of making a mortgage, or a promissory note, but he is not incapable of becoming a mortgagee or a payee he can derive benefit under the contract.

3. A minor's agreement cannot be ratified by the minor on his attaining majority as the agreement is void *ab initio*.

4. If a minor has received any benefit under a void contract, he cannot be asked to refund the same (see *Mohisi Bibi's* case given above).

5. A minor is always allowed to plead minority, and is not estopped to do so even where he had procured a loan or entered into some other contract by falsely representing that he was of full age.

6. A minor cannot be a partner in a partnership firm. However, a minor may, with the consent of all the partners for the time being, he admitted to the benefits of partnership (section 36 the Indian Partnership Act, 1932).

7. A minor's estate is liable to a person who supplies necessaries of life to a minor, or to one whom the minor is legally bound to support, according to his station in life. This liability of the minor is not on the basis of any contract, but on the basis of an obligation resembling a contract. However, there is no personal liability of a minor for the necessaries of life as supplied.

8. A minor's parents/guardians are not liable to a minor's creditor for the breach of contract by the minor, whether the contract is for necessaries or otherwise. However, the parents are liable where the minor is acting as their agent.

3.1.3 Mental Incompetence Prohibits a Valid Contract

A person who is not of sound mind may not enter into a contract; he must be of sound mind so as to be competent to contract. A test of soundness of mind has been laid down by law. A person is said to be of unsound mind for the purpose of making a contract if at the time he makes it he

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is incapable of understanding it and of forming a rational judgement as to its effect upon his interests. A person who is usually of unsound mind but occasionally of sound mind may make a contract when he is of sound mind (s.12).

Examples:

(i) A patient is in a lunatic asylum. He is, at intervals, of sound mind. He may contract during those intervals.

(ii) A sane person, who is delirious from fever or who is so drunk that he cannot understand the terms of a contract or form a rational judgement as to its effect on his interests, cannot contract whilst such delirium or drunkenness lasts.

The soundness of a person depends on two facts: (i) his capacity to understand the terms of the contract, and (ii) his ability to form a rational judgement as to its effect upon his interests. If a person is incapable of both, he suffers from unsoundness of mind. Idiots, lunatics and drunken persons are examples of those having an unsound mind. But whether a party to a contract, at the time of entering into the contract, is of sound mind is a question of fact to be taken into account by a court. There is a presumption that a person is sane but this presumption is rebuttable. The person interested in proving the unsoundness of a person has to satisfy the court.

The liability for necessaries of life supplied to persons of unsound mind is the same as for minors.

A lunatic is a person who is mentally deranged due to some mental strain or other personal experience. However, he has some lucid intervals of mind. As regards contracts entered into during lucid intervals he is bound. However, he is not liable for contracts entered into while he is of unsound mind. In general his position is identical with that of a minor i.e, the contract is void but the same exceptions as discussed above (under minor's contracts) are relevant.

An idiot is a person who is of permanently unsound mind. He does not have lucid intervals. He is incapable of entering into a contract and therefore a contract with an idiot is void. However, like a minor, his property, if any, shall be liable for necessaries of life supplied to him. Also he can be a beneficiary.

A person who is drunk, intoxicated or delirious from fever so as to be incapable of understanding the nature and effect of an agreement or form a rational judgement as to its effect on his interests cannot enter into valid contracts whilst such drunkenness or delirium lasts. Thus, an intoxicated person may get out of a contract provided he did not have mental capacity to understand what he was doing and to appreciate its effects on his interests at the time when he made the contract.

Sometimes a person may not be competent to contract because of his status. Such an incompetency to contract may arise from either political, corporate, legal status, etc.

3.1.4 Alien Enemy (Political Status)

An alien is a person who is a citizen of a foreign country. Thus, in the Indian context, an alien is a person who is not a citizen of India. An alien may be (i) an alien friend or (ii) an alien enemy. An alien friend whose country is at peace with the Republic of India, has usually the full contractual capacity of a natural born subject. In case of contracts with an alien enemy (i.e., an alien whose country is at war with India) the position may be studied under two heads; (a) contracts during the war; and (b) contracts made before the war. During the subsistence of the war an alien can neither contract with an Indian subject nor can he sue in an Indian court except by licence from the Central Government. As regards contracts which are against the public policy or are such which would benefit the enemy stand dissolved. Other contracts (i.e. not against public policy) are merely suspended for the duration of the war, and are revived after the war is over provided they have not already become time-barred under the law of limitation. Further an Indian, who

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resides voluntarily or who is carrying on business in a hostile territory, would be treated as an alien enemy.

However, an alien friend, whose country is at peace with the Republic of India, has usually, the full contractual capacity of a natural born Indian subject. But he cannot acquire property on any Indian Ship, and also cannot be employed a Master or any other Chief Officer of such a ship.

3.1.5 Foreign Sovereigns and Ambassadors (Political Status)

Foreign sovereigns and accredited representatives of a foreign state or Ambassadors can enter into contracts and enforce those contracts in our courts. However, they enjoy some special privileges. They cannot be sued in our courts unless they choose to submit themselves to the jurisdiction of our courts. In fact they cannot be proceeded against in Indian courts without the sanction of the Central Government.

A company incorporated under the Companies Act, 1956, or a statutory corporation brought into existence by passing a Special Act of Parliament (corporate status). A company cannot go beyond its objects mentioned in its memorandum of association. The company's activities are confined strictly to the objects mentioned in its memorandum, and if they go beyond these objects, then such activities are ultra vires and void, and cannot be ratified even by the assent of the whole body of shareholders. Also, a statutory corporation cannot go beyond the objects mentioned in the Special Act of Parliament. Similarly, Municipal Corporations (local bodies) are disqualified from entering into contracts which are not within their statutory powers.

Insolvent persons (legal status). A person adjudicated as insolvent is incompetent to contract until he obtains a certificate of discharge from the court.

3.2 Meaning of Consideration

One of the essential elements of a valid contract is that it must be supported by consideration. In simple terms consideration is what a promisor demands as the price for his promise. The term consideration is used in the sense of quid pro que, i.e., "something in return". This something or consideration need not be in terms of money. This "something" may even be some benefit, right, interest or profit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other party. Also a promise by one party may be consideration for the promise of other party. Thus, a person who makes a promise to do something usually does so as a return of equivalent of some loss, damage or inconvenience that may have been occasioned to the other party in respect of the promise. The benefit so received, or the loss, damage or inconvenience so caused is regarded, in law, as the consideration for the promise.

Section 2 (d) defines consideration 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".

Example: A agrees to sell his motorcycle to B for ₹ 20,000. Here B's promise to pay the sum of ₹ 20,000 is the consideration for A's promise to deliver the motorcycle, and A's promise to deliver the motorcycle is the consideration for B's promise to pay ₹ 20,000.

"No Consideration, No Contract" [Ss.10 and 25]

A promise without consideration cannot create a legal obligation. A person who makes a promise to do or abstain from doing something usually does so as a return of equivalent of some loss, damage, or inconvenience that may have or may have been occasioned to the other party in

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respect of the promise. The benefit so received or the loss, damage or inconvenience so caused is regarded in law as the consideration for the promise.

Exceptions to the rule "no consideration, no contract". There are some cases where contracts, even though not supported by consideration, are enforceable. These are:

1. An agreement made without consideration is valid if it is expressed in writing and is registered under the law relating to registration of documents and is made an account of natural love and affection between parties standing in a near relation to each other.
2. A promise without consideration is valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something the promisor was legally compellable to do. Thus, where A finds B's purse and gives it to him, and B promises to give A ₹ 100, this a valid contract.
3. A promise to pay wholly or in part a debt which is barred by the Limitation Act can be enforced if it is in writing and is signed by the debtor or his authorised agent. A debt barred by limitation cannot be recovered. Therefore, a promise to pay such a debt is, strictly speaking, without any consideration. But if a written promise to pay is made by the debtor then the same is enforceable by the creditor.
4. The rule 'no consideration, no contract' does not apply to completed gifts.
5. No consideration is required in the case of an agreement between a principal and an agent (s.185).

Example: An elder brother, on account of natural love and affection, promised to pay the debts of his younger brother. The agreement was put to writing and was registered. This was held to be a valid agreement, even though there was no consideration for the promise.

Task

Give an example related to consideration.

3.3 Rules regarding Consideration

The following rules as regards consideration emerge from the definition given in s.2 (d):

1. ***Consideration must move at the desire of the promisor*** and therefore an act done by the promise at the desire of a third party is not a consideration.
2. ***Consideration may move either from the promisee or any other person.*** It is not necessary that the consideration must move from the promisee. It may move from any other person. In such a situation, the promisee can maintain a suit even if he is a stranger to the consideration. But he must not be a stranger to the contract.

   Capacity of a stranger to consideration to file a suit. We have seen earlier that a stranger to a contract cannot maintain a suit. However, a stranger to consideration can maintain a suit. Consideration may be supplied either by promisee or any other person.

Example: A, a lady, by a deed of gift, transferred certain property to her daughter with a direction that the daughter should pay an annuity to A's brother as had been done by A. On the same day, the daughter executed a writing in favour of A's brother agreeing to pay the annuity. Afterwards, she declined to fulfill her promise saying that no consideration had moved from A's brother to her. A's brother was held entitled to recover the money (*Chinnayya v. Ramayya*, 4 Mad 137).

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3. ***Consideration need not be adequate.*** How much consideration or payment must there be for a contract to be valid, is always the lookout of the promisor. Courts do not see whether a person making the promise has recovered full return for the promise. Thus, if A promises to sell his pen worth ₹ 80 for ₹ 20 only the inadequacy of the price in itself shall not render the contract void. But where A pleads coercion, undue influence or fraud, then the inadequacy of consideration will also be a piece of evidence to be looked into.

4. ***Consideration must be real and competent.*** A consideration for a contract must be real and not illusory. Also, the consideration must be competent, i.e., it must be something to which law attaches some value.

Example:

(i) A promises to discover treasure by magic. The agreement is void, being illusory.

(ii) A received summons to appear as a witness at a trial. B, a party to the suit, promises to pay A ₹ 1000 in addition to A's expenses. The promise of B is not enforceable as A was under a legal duty to appear and give evidence. The agreement is void as it is without competent consideration.

(iii) A promises to pay an existing debt punctually if B, the creditor, gives him discount. B agrees to give discount. The promise to give discount is without consideration and cannot be enforced.

5. ***Consideration must be legal.*** Illegal consideration renders a contract void.

6. ***A consideration may be present, past or future.*** A consideration which moves simultaneously with the promise is called present (or executed) consideration. 'Cash Sales' provides an excellent example of the present consideration. Where the consideration is to move at a future date it is called future or executory consideration. It takes the form of a promise to be performed in the future.

Example: A, a shopkeeper, promises B, a household lady, to deliver certain items of grocery after three days. B promises to pay for it on delivery.

A past consideration is something wholly done, forborne or suffered before the making of the contract.

Example: A saves B's life. B promises to pay A ₹ 10,000 out of gratitude. The consideration for B's promise is a past consideration, something done before making of the promise.

3.4 Unlawful Consideration and Object [Ss.23-24]

There are certain cases in which the consideration and the object of an agreement are unlawful, thereby making it unenforceable. Section 23 defines an illegal agreement as one the consideration or object of which (i) is forbidden by law; or (ii) defeats the provisions of any law; or (iii) is fraudulent; or (iv) involves or implies injury to the person or property of another; or (v) the court regards it as immoral or opposed to public policy.

(i) ***Where it is forbidden by law.*** A loan granted to the guardian of a minor to enable him to celebrate the minor's marriage in contravention of the Child Marriage Restraint Act is illegal and cannot be recovered (*Srinivas v. Raja Ram Mohan* (1951) 2. M.L.J. 264). A promises to drop a prosecution which he has instituted against B for robbery and B promises to restore the value of the things taken. The agreement is void as its object is unlawful.

(ii) ***Where it is of such a nature that if permitted it would defeat the provisions of any law.*** A let a flat to B at a rent of ₹ 12,000 a month. With a view to reduce the municipal tax, A

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made two agreements with B. One by which the rent was stated to be ₹ 4,500 only and the other by which B agreed to pay ₹ 7,500 for services in connection with the flat. Held, A could not recover ₹ 7,500 since the agreement was made to defraud the municipal authority and thus void [*Alexander v. Rayson* (1939) IK.B.169].

(iii) ***Where it is fraudulent.*** A, being an agent for a landed proprietor, agrees for money without the knowledge of his principal to obtain for B, a lease of land belonging to his principal. The agreement between A and B is void as it implied a fraud by concealment by A, on his principal.

(iv) ***Where it involves or implies injury to the person or property of another.*** An agreement between some persons to purchase shares in a company, with a view to induce other persons to believe contrary to the fact that there is a bona fide market for the shares, is void.

(v) ***Where the court regards it as immoral or opposed to public policy.*** A who is B's power of attorney promises to exercise his influence as such with B in favour of C, and C promises to pay ₹ 5,000 to A. The agreement is void being against public policy.

Example:

(i) X agrees to buy from a jeweller certain jewellery to be delivered to him after two months. In the meantime, the government enacts a law on gold control and prohibits dealings in gold. When the time for delivery of the jewellery comes the jeweller refuses to deliver the same. What can X do? He has no cause of action. The contract becomes void when the law is enacted. Thus, the contract was originally valid but becomes void later on by subsequent (supervening) illegality.

(ii) A dealer enters into a contract to sell a smuggled item to X. The import of such type of goods is illegal under the laws of the country. A refuses to deliver the item as promised. What are the rights of X? The contract is void.

3.5 Agreements Declared Void [Ss.26-30]

The Act declares certain agreements to be void. Some of them (such as the following) have already been explained: (i) agreements entered into through a mutual mistake of fact between the parties (s. 20). (ii) agreements, the object or consideration of which is unlawful (s. 23); (iii) agreements, part of consideration of which is unlawful (s. 24); (iv) agreements made without consideration (s. 25). Some other agreements which are declared to be void are explained below.

3.5.1 Agreements against Public Policy (Ss.26-28)

An agreement which conflicts with morals of the time and contravenes any established interest of society is void as being against public policy. Some of the agreements which are against public policy and have been declared to be void by law. These are as follows:

(i) ***Trading with enemy:*** All contracts made with an alien (foreigner) enemy are illegal unless made with the permission of the government.

(ii) ***Agreements for stifling prosecution.*** The agreements for compounding or suppression of criminal charges, and for offences of a public nature are illegal and void. A, knowing that B has committed a murder, obtains a promise from B to pay him (A) ₹ 10,000 in consideration of not exposing B. This is a case of stifling prosecution, and the agreement is illegal and void.

(iii) ***Contracts in the nature of champerty and maintenance.*** Where a person, having no interest, agrees to maintain a suit on behalf of another against a third party, it is known as

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maintenance. It tends to encourage speculative litigation. Champerty is a bargain whereby one party is to assist another in recovering property, and in turn, is to share in the proceeds of the action. Champerty and maintenance are not illegal but courts refuse to enforce such agreements when they are found to be extortionate and unconscionable and not made with the bona fide object of assisting the claims of the person unable to carry on litigation himself

(iv) ***Agreement for the sale of public offices and titles are void.*** Thus, where A promises to pay B ₹ 5,000 if B secures him an employment in the public service the agreement is void.

(v) Agreements in restraint of parental rights are void.

(vi) Agreements in restraint of marriage of any person other than a minor is void.

(vii) Marriage brokerage (such as dowry) or brokage contracts are unlawful and void.

(viii) Agreements in restraint of legal proceedings are void.

(ix) Agreements interfering with the course of justice are void. Any agreement for the purpose of using improper influence of any kind with judges or officers of justice is void.

(x) Agreements in restraint of trade are void. Thus, every agreement by which one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

Examples:

(i) A promises to render services for the conduct of litigation in consideration of payment of 50 percent of the amount recovered through court. The agreement is legally enforceable.

(ii) A, a financier, promises to spend ₹ 30,000 for the consideration that a part of the estate recovered through litigation will be conveyed to him, the value of which amounted to ₹ 90,000. Though the agreement bona fide, it would not be enforced, the reward being extortionate and unconscionable.

3.5.2 Agreement in Restraint of Trade

Section 27 provides that "every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind is, to that extent, void". All agreements in restraint of trade, whether general or partial, qualified or unqualified, are void. It is, therefore, not open to the courts to enter into any question of reasonableness or otherwise of the restraint [*Khemchand v. Dayaldas*, (1942) Sind, 114].

Examples:

(i) 29 out of 30 manufacturers of combs in the city of Patna agreed with R to supply him with combs and not to any one else. Under the agreement, R was free to reject the goods if he found there was no market for them. Held, agreement amounted to restraint of trade and was thus void [*Shaikh Kalu v. Ram Saran Bhagat* (1909) 13 C.W.N.388].

(ii) J, an employee of a company, agreed not to employ himself in a similar concern within a distance of 800 miles from Chennai after leaving the company's service. Held, the agreement was void [*Oakes & Co. v. Jackson* (1876) 1 Mad.134].

(iii) A and B carried on business of readymade garments in a certain locality in Calcutta. A promised to stop business in that locality if B paid him ₹ 900 which he had paid to his workmen as advances. A stopped his business but B did not pay him the promised money. Held, the agreement was void and, therefore, nothing could be recovered on it (*Madhab Chander v. Raj Coomar* (1874) 14 Beng L.R. 76].

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Cases in which restraint of trade is valid. The following are the exceptions to the above rule that a restraint of trade is void:

1. ***Sale of goodwill of a business.*** The seller of the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer or any one deriving title to the goodwill from him carries on a like business, provided that such limits are reasonable (s.27).

Example: S, a seller of imitation jewellery, sells his business to B and promises not to carry on business in imitation jewellery and real jewellery. Held, the restraint with regard to imitation jewellery was valid but not regarding real jewellery [*Golds Roll v. Goldman* (1915) 6 Ch. 292].

2. ***Partners' agreement.*** Partners may agree that: (i) a partner shall not carry on any business other than that of the firm while he is a partner [s.11(2) of Indian Partnership Act, 1932]; (ii) a partner on ceasing to be a partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. The agreement shall be valid if the restrictions are reasonable [s.3 (2) of Indian Partnership Act, 1932]; (iii) partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and such agreement shall be valid if the restrictions imposed are reasonable [s.54 of Indian Partnership Act, 1932]; (iv) a partner may, upon the sale of the goodwill of a firm, make an agreement that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits; and such agreement shall be valid if the restrictions imposed are reasonable [s.55 of Indian Partnership Act, 1932].

3. ***Restrictive trade agreements.*** The trade combinations and restrictive trade practices are not treated as void simply because they restrain some party or the other from freedom of occupation. For instance, if a few manufacturers of a particular product want to regulate the sale price, by an agreement, but it is not against the public interest, then such an agreement would not be void. Sometimes a restrictive trade practice or agreement may be in the public interest. Section 33 of the Monopolies and Restrictive Trade Practices Act, 1969, states that every agreement falling within one or more of the categories mentioned therein shall be deemed, for the purpose of that Act, to be an agreement relating to restrictive trade practices and shall be subject to registration under s.35 of that Act. Further, s.37 empowers the Director General of Investigation and Registration to order either the modification, or the termination, of such agreements if they go against public interest.

4. ***Service agreements.*** An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else or directly or indirectly take part in or promote or aid any business in direct competition with that of his employer is valid. Like any other contract, damages can be claimed for breach of contract of service. Section 73 (first two paragraphs) provides that the party suffering by breach of contract is entitled to receive, from the party breaking the contract, compensation for loss or damage of the specified category.

Service bonds. These days, it is a common practice to appoint management trainees. The organisations spend a lot of time, money and energy in training them in the management techniques. So, it will be very unfair to these organizations if trainees left for other organizations immediately after training. Therefore, a service bond is normally got signed by the trainee, containing a provision that he shall not leave the organization before the expiry of a specified period and further, that if he does so, then he shall have to pay a particular sum of money to the organization. This is just to indemnify the organization which has incurred some expenditure on the training of the trainee. But if the amount of the bond is excessive and disproportionate, the court has jurisdiction to reduce that amount.

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This is because of the fact that essentially, a service bond is a species of contract and the principles of the law of contracts as to penal stipulations apply to such bonds. Section 74 that only reasonable compensation can be recovered in case of breach of contract. If the amount specified in the contract is exaggerated, the court can reduce it.

3.5.3 Restraint of Legal Proceedings (S.28)

Every person has a right to have recourse to the usual legal proceedings. Therefore, s.28 renders void an agreement by which a party is restricted absolutely from enforcing his legal rights arising under a contract by the usual legal proceedings in the ordinary tribunals.

Example: A contract contains a stipulation that no action should be brought upon it in case of breach. Such a stipulation would be void because it would restrict both parties from enforcing their rights under the contract in the ordinary tribunals.

However, an exception to s.28 provides that an agreement to refer disputes to arbitration is valid as this stipulation itself would not have the effect of ousting the jurisdiction of the courts.

Examples:

(i) A contract whereby it is provided that all disputes arising between the parties should be referred to an arbitrator, whose decision shall be accepted as final and binding on both parties of the contract, is not invalid.

(ii) A contract contains a double stipulation. Firstly, any dispute between the parties would be settled by arbitration. Secondly, neither party would enforce his rights under the contract in a court of law. In such a situation, the first stipulation is valid, but the second one is void.

Ousting the jurisdiction of all other courts except one. The restriction imposed upon the right to sue should be absolute in the sense that the parties are precluded from pursuing their legal remedies in the ordinary tribunals. Thus, where there are two courts, both of which have jurisdiction to try a suit, an agreement between the parties that the suit should be filed in one of those courts alone and not in the other, does not contravene the provisions of s.28, as it is not against public policy [*Hakam Singh v. Gammon (India) Ltd*; A.I.R. 1971 S.C. 740].

Limitation of time. Section 28 renders void another kind of agreement, namely, whereby an attempt is made by the parties to restrict the time within which an action may be brought so as to make it shorter than that prescribed by the Limitation Act, 1963.

Example: A clause in an agreement provides that no action should be brought after two years. However, according to the Limitation Act, 1963, an action for breach of contract may be brought within three years from the date of the breach. The clause in the agreement is void, as it is opposed to the provisions of the Limitation Act, 1963.

3.5.4 Uncertain or Ambiguous Agreements (S. 29)

Agreements, the meaning of which is not certain or capable of being made certain, are void.

Example:

(i) A agrees to sell to B 100 tonnes of oil. There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

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(ii) A, who is a dealer in coconut oil only, agrees to sell to B "100 tonnes of oil". The nature of A's trade affords an indication of the meaning of the words, and that A has entered into a contract for the sale of 100 tonnes of coconut oil.

(iii) A agrees to sell to B, "his white Maruti car for ₹ 1.35 lakhs or ₹ 1.25 lakhs". There is nothing to show which of the prices was to be given. The agreement is void.

(iv) A agrees to sell to B, "100 quintals of rice at a price fixed by C". As the price is capable of being made certain, there is no uncertainty to make the contract void.

3.5.5 Wagering Agreements (S. 30)

"A wagering agreement", says Sir William Anson, "is a promise to give money or money's worth upon the determination of an uncertain event". Cockburn C.J. defined it as "A contract by 'A' to pay money to 'B' on the happening of a given event in consideration of 'B's promise to pay money to 'A' on the event not happening. Thus, a wagering agreement is an agreement under which money or money's worth is payable, by one person to another on the happening or non-happening of a future, uncertain event. The essence of gaming and wagering is that one party is to win and the other to lose upon a future event, which at the time of the contract is of an uncertain nature – that is to say, if the event turns out one way A will lose but it turns out the other way, he will win. An agreement by way of wager is void.

Example:

(i) A and B bet as to whether it would rain on a particular day or not – A promising to pay ₹ 100 to B if it rained, and B promising an equal amount to A, if it did not. This agreement is a wager.

(ii) A and B agree to deal with the differences in prices of a particular commodity. Such an agreement is a wager.

Wagering agreement void and not illegal. In India, unless the wager amounts to a lottery, which is a crime under s. 294-A of the Indian Penal Code, it is not illegal but simply void. Thus, except in case of lotteries, the collateral transactions remains enforceable.

Example: A borrows ₹ 500 from B to pay to C, to whom B has lost a bet. The contract between A and B is valid.

Lotteries. 'Lottery' is an arrangement for the distribution by chance among persons purchasing tickets. The dominant motive of the participants need not be gambling. Where a wagering transaction amounts to a lottery, it is illegal under s. 294-A of the Indian Penal Code. In *Sir Dorabji Tata v. Edward F Lance* (1918) I.L.R. 42 Bom. 676, where the Government of India had sanctioned a lottery, the Court held that the permission granted by the Government will not have the effect of overriding s. 30 and making such a lottery legal. Its only effect was that the persons responsible for running the lottery could not be punishable under the Indian Penal Code.

However, in *H.Anraj v. Govt of Tamil Nadu*, AIR 1986 SC 63, the Supreme court upheld lotteries with the prior permission of the Government as legal thereby conferring upon the winner of a lottery, a right to receive the prize and the sale of lotteries subject to payment of sales tax. A sale of lottery ticket confers on the purchaser thereof two rights (a) a right to participate in the draw and (b) a right to claim a prize contingent upon his being successful in the draw.

Exceptions (transactions held 'not wagers'). The following transactions have been held not to be wagers:

1. Transactions for the sale and purchase of stocks and shares, or for the sale and delivery of goods, with a clear intention to give and take delivery of shares or goods, as the case may

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be. However, where the intention is only to settle in price difference, the transaction is a wager and hence void.

2. Prize competitions which are games of skill, e.g., picture puzzles, athletic competitions are not wagers. Thus, an agreement to enter into a wrestling contest in which the winner was to be rewarded by the entire sale proceeds of tickets, was held not to be wagering contract (*Babalalteb v. Rajaram (1931) Odham's Press*' (1936)1K. 416 it was held that a crossword puzzle in which prizes depend upon correspondence of the competitor's solution with a previously prepared solution kept with the editor of a newspaper is a lottery and therefore, a wagering transaction. According to Prize Competition Act, 1955, prize competitions in games of skill are not wagers provided the prize money does not exceed ₹ 1,000.

3. An agreement to contribute a plate or prize of the value of ₹ 500 or above to be awarded to the winner of a horse race (s.30).

4. Contracts of insurance are not wagering agreements even though the payment of money by the insurer may depend upon a future uncertain event. Contracts of insurance differ from the wagering agreements in the following respects:

   (a) It is only that person possessing an insurable interest who is permitted to insure life or property and not any person, as in the case of a wager.

   (b) In the case of fire and marine insurance, only the actual loss suffered by the party is paid by the insurance company, and not the full amount for which the property is insured. Even in the case of life insurance, the amount payable is fixed only because of the difficulty in estimating the loss caused by the death of the assured in terms of money, but the underlying idea is only indemnification.

   (c) Contracts of insurance are regarded as beneficial to the public and are, therefore, encouraged. Wagering agreements, on the other hand, are considered to be against public policy.

3.6 Summary

- Any one cannot enter into a contract; he must be competent to contract according to the law. Every person is competent to contract if he (i) is of the age of majority, (ii) is of sound mind, and (iii) is not disqualified from contracting by any law to which he is subject (s.11). Thus, there may be a flaw in the capacity of parties to the contract. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness, drug addiction or status. If a party to a contract suffers from any of these flaws the contract may not be a valid one. If the contract would have been allowed to be a valid one then it would result in one party being at a disadvantage in the bargaining process.
- The goods are 'necessaries', for that particular minor having regard to his conditions in life (or status or standard of living) and that purchase or hire of a car may be 'necessary' for a particular minor. The minor needs the goods both at the time of sale and delivery. What is necessary to see is the minor's actual requirements at the time of sale and at the time of delivery, where these are different.
- A minor's agreement cannot he ratified by the minor on his attaining majority as the agreement is void ab initio.
- If a minor has received any benefit under a void contract, he cannot be asked to refund the same (see Mohisi Bibi's case given above).
- A minor is always allowed to plead minority, and is not estopped to do so even where he had procured a loan or entered into some other contract by falsely representing that he was of full age.

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- A minor cannot be a partner in a partnership firm. However, a minor may, with the consent of all the partners for the time being, he admitted to the benefits of partnership (section 36, the Indian Partnership Act; 1932).
- A person who is drunk, intoxicated or delirious from fever so as to be incapable of understanding the nature and effect of an agreement or form a rational judgement as to its effect on his interests cannot enter into valid contracts whilst such drunkenness or delirium lasts. Thus, an intoxicated person may get out of a contract provided he did not have mental capacity to understand what he was doing and to appreciate its effects on his interests at the time when he made the contract.
- Foreign sovereigns and accredited representatives of a foreign state or Ambassadors can enter into contracts and enforce those contracts in our courts. However, they enjoy some special privileges. They cannot be sued in our courts unless they choose to submit themselves to the jurisdiction of our courts. In fact they cannot be proceeded against in Indian courts without the sanction of the Central Government.
- Section 2 (d) defines consideration 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".
- A promise without consideration is valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something the promisor was legally compellable to do. Thus, where A finds B's purse and gives it to him, and B promises to give A ₹ 100, this a valid contract.
- A promise to pay wholly or in part a debt which is barred by the Limitation Act can be enforced if it is in writing and is signed by the debtor or his authorised agent. A debt barred by limitation cannot be recovered. Therefore, a promise to pay such a debt is, strictly speaking, without any consideration. But if a written promise to pay is made by the debtor then the same is enforceable by the creditor.
- Consideration must move at the desire of the promisor and therefore an act done by the promise at the desire of a third party is not a consideration.
- The Act declares certain agreements to be void. Some of them (such as the following) have already been explained: (i) agreements entered into through a mutual mistake of fact between the parties (s. 20). (ii) agreements, the object or consideration of which is unlawful (s. 23); (iii) agreements, part of consideration of which is unlawful (s. 24); (iv) agreements made without consideration (s. 25).
- The seller of the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer or any one deriving title to the goodwill from him carries on a like business, provided that such limits are reasonable (s.27).
- Every person has a right to have recourse to the usual legal proceedings. Therefore, s.28 renders void an agreement by which a party is restricted absolutely from enforcing his legal rights arising under a contract by the usual legal proceedings in the ordinary tribunals.

3.7 Keywords

Agreements: The meaning of which is not certain or capable of being made certain, are void.

Alien: It is a person who is a citizen of a foreign country.

Idiot: It is a person who is of permanently unsound mind.

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Illegal consideration: Renders a contract void.

Lunatic: It is a person who is mentally deranged due to some mental strain or other personal experience.

Restrictive trade agreements: Trade combinations and restrictive trade practices are not treated as void simply because they restrain some party or the other from freedom of occupation.

Service agreements: An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else or directly or indirectly take part in or promote or aid any business in direct competition with that of his employer is valid.

3.8 Self Assessment

Fill in the blanks:

1. A ..... cannot be a partner in a partnership firm.
2. ..... provides that a minor's estate is liable to a person who supplies necessaries of life to a minor, or to one whom the minor is legally bound to support, according to his station in life, not on the basis of any contract, but on the basis of an obligation resembling a contract.
3. A minor's estate is ..... not only for the necessary goods but also for the necessary services rendered to him.
4. A person adjudicated as ..... is incompetent to contract until he obtains a certificate of discharge from the court.
5. An ..... made without consideration is valid if it is expressed in writing and is registered under the law relating to registration of documents and is made an account of natural love and affection between parties standing in a near relation to each other.
6. ..... renders a contract void.
7. An agreement which ..... with morals of the time and contravenes any established interest of society is void as being against public policy.
8. ..... provides that "every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind is, to that extent, void".
9. Every person has a right to have recourse to the usual ..... .
10. Section 28 renders void another kind of agreement, namely, whereby an attempt is made by the parties to restrict the time within which an action may be brought so as to make it shorter than that prescribed by the ..... .

3.9 Review Questions

1. Who is competent to contract?
2. What determines enough maturity to make a contract?
3. Can anyone enter into a contract?
4. When does mental incompetence prohibit a valid contract? Is minor competent to contract?
5. "A minor's estate is liable for necessaries of life supplied". Comment.
6. "Insufficiency of consideration is immaterial but an agreement without consideration is void". Comment.

7. Consideration may be present, past or future. Illustrate. **Notes**
8. Are there any exceptions to the rule "No consideration, No contract".
9. "A stranger to a contract cannot maintain a suit but a stranger to consideration can do so", comment.
10. The term consideration is used in the sense of 'quid pro quo' or 'something in return'. Does this 'something' to be necessarily in terms of money? Illustrate your answer.

Answers: Self Assessment

1.	minor	2.	Section 68
3.	liable	4.	insolvent
5.	agreement	6.	Illegal consideration
7.	conflicts	8.	Section 27
9.	legal proceedings	10.	Limitation Act, 1963

3.10 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S .S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

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Unit 4: Free Consent

CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain the meaning of consent
- Discuss coercion, undue influence and fraud
- Discuss misrepresentation

Introduction

As you all know that the law relating to contracts is contained in the Indian Contract Act, 1872. For business executives, contract law is tremendously significant because it underlies or is related to all major areas of law affecting business. In last unit you have studied about capacity of contact. Anyone can enter into a contract; he must be competent to contract according to the law. The flaw in capacity may be due to minority, lunacy, idiocy, drunkenness, drug addiction or status. In this unit you will study meaning of free consent and fraud.

4.1 Meaning of Consent

We have seen earlier that an offer by one party is accepted by the other party. The consent of the offeree to the offer by the offeror is necessary. It is essential to the creation of a contract that both parties agree to the same thing in the same sense. When two or more persons agree upon the same thing in the same sense they are said to consent.

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Example:

(i) A agrees to sell his Maruti car Delux model for ₹ 1.20 lakhs. B agrees to buy the same. There is a valid contract since A and B have consented to contract on the same subject matter.

(ii) A who owns two Maruti cars, offers to sell one, say, yellow-coloured, to B for ₹ 1.20 lakhs. B agrees to buy the car for the price thinking that A is selling the other car red-coloured. There is no consent and hence no contract. A and B have agreed not to the same thing but are thinking for different cars.

(iii) A signed a promissory note which he was told was a letter of guarantee. He was held not liable on the promissory note, as there was no consent and consequently no agreement entered into by him.

Free consent. For a contract to be valid it is not only necessary that the parties consent but also that they consent freely. Where there is a consent but no free consent the contract is voidable at the option of the party whose consent was not free. Thus, free consent is one of the essentials of a valid contract. A consent is said to be free when it is not caused by: (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation or (v) mistake.

4.2 Meaning of Coercion (Ss. 15 and 72)

Coercion is (i) the committing or threatening to commit any act forbidden by the Indian Penal Code or (ii) 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. [s.15].

Example: A threatens to kill B if he doesn't transfer his house in A's favour for a very low price. The agreement is voidable for being the result of coercion.

However, it is not necessary that coercion must have been exercised against the promisor only, it may be directed at any person.

Example: A threatens to kill B (C's son) if C does not let his house to A and thereupon C gives his consent. This consent is no consent in the eye of law as the agreement is caused by coercion.

Threat to commit suicide - Is it coercion? The doubt arises because suicide, though forbidden by the Indian Penal Code, is for obvious reasons not punishable. A dead person cannot be punished. But, since s.15 declares that committing or threatening to commit any act forbidden by the Indian Penal Code is coercion, a threat to commit suicide should obviously be so regarded (suicide being forbidden).

Example: A obtained a release deed from his wife and son under a threat of committing suicide. The transaction was set aside on the ground of coercion [*Ammiraju v. Seshamma* (1917) 41 Mad.33].

Effect of coercion on the validity of contract (s.19A). When consent to an agreement is caused by coercion the agreement is voidable at the option of the party whose consent was so obtained. Thus, the aggrieved party can have the contract set aside if he so desires otherwise the contract is a valid one. However, a person, to whom money has been paid or anything delivered under coercion, must repay or return it to the other party (s.72).

Example: A railway company refused to deliver certain goods to the consignee except upon the payment of an illegal charge for carriage, and he paid the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

Notes

4.3 Meaning of Undue Influence (S. 16)

Undue influence consists in the improper exercise of power over the mind of one of the contracting parties by the other. A contract is said to be induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

Example: A, a man enfeebled by disease or age, is induced by B's influence over him as his medical attendant to agree to pay B an unreasonable sum for his professional services, B employs undue influence.

Presumption of undue influence as regards persons in particular relationships. After reciting the general principle of undue influence, s.16 lays down rules of presumption as regards persons in particular relations. It reads: A person is deemed to be in a position to dominate the will of another: (i) where he holds a real or apparent authority over the other or where he stands in a fiduciary relation to the other or (ii) where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily stress. Some of the relationships which raise a presumption of undue influence are: (a) parent and child; (b) guardian and ward; (c) doctor and patient; (d) spiritual guru and disciple; (e) lawyer and client; (f) trustee and beneficiary. However, the presumption of undue influence can be rebutted by showing that the party said to have been influenced had independent legal advice of one who had full knowledge of the relevant facts.

Example: A Hindu, well advanced in age, with the object of securing benefits to his soul in the next world, gave away his whole property to his spiritual guru. Undue influence was presumed.

There is no presumption of undue influence in the relationships between (i) husband and wife; (ii) master and servant; (iii) creditor and debtor; (iv) landlord and tenant.

Party on whom lies the burden of proving that the contract (i) was or (ii) was not induced by undue influence [s.16(3)]. The burden of proving that the contract is not induced by undue influence lies on the party who is in a position to dominate the will of the other. Thus, in cases (above given) where undue influence is presumed the onus of proof lies on parent, guardian, doctor, spiritual guru, lawyer, trustee. On the other hand, in relationships where undue influence is not presumed the party alleging undue influence must prove that it existed.

Consequences of undue influence (s.19A). An agreement caused by undue influence is voidable at the option of the party whose consent was obtained by undue influence. However, any such contract may be set aside either absolutely or if the party who was entitled to avoid it has received any benefit there under then upon such terms and condition as the court deems fit.

Example: A, a money lender, advanced ₹ 1,000 to B, a household lady, and by undue influence induced B to execute a bond with interest at 8 percent per month then the court may set the bond aside ordering B to repay ₹ 1,000 with such interest as the court may deem just.

Extra precautions to be taken while entering into contract with a pardanashin woman. A pardanashin woman is one, who according to the custom of her community, observes complete seclusion. The courts in India regard such women as being especially open to undue influence. When therefore an illiterate pardanashin woman is alleged to have dealt with her property and to have executed a deed, the burden of proving that there was no undue influence was on the party setting up the deed. The law demands that the person who deals with a pardanashin lady must show affirmatively and conclusively that the deed was not only executed by, but was explained to and was really understood by the lady.

Notes

Money lending transactions. In money lending transactions, the rate of interest being high, or that the borrower is in urgent need of money is not an evidence of undue influence. These two facts do not by themselves show that there is undue influence. However, if the rate of interest is so high that the court considers it unconscionable, then the burden of proving that there was no undue influence lies on the creditor.

Example: A, being in debt to B, the money lender, contracts for a fresh loan at compound interest of 25 percent the transaction may be held to be unconscionable and a reduced rate of simple interest may be awarded.

4.4 Meaning of Fraud [Ss.17 and 19]

Fraud means and includes any of the following acts committed by a party to a contract with an intent to deceive the other party thereto or to induce him to enter into a contract: (i) the suggestion as a fact of that which is not true by one who does not believe it to be true; (ii) active concealment of a fact by one having knowledge or belief of the fact; (iii) promise made without any intention of performing it; (iv) any other act fitted to deceive; (v) any such act or omission as the law specifically declares to be fraudulent.

Essential elements or conditions for a fraud to exist. For a fraud to exist the following are the essential elements:

1. There must be a representation or assertion and it must be false. To constitute fraud there must be an assertion of something false within the knowledge of the party asserting it. Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud. To constitute fraud ordinarily there must be active misstatement of fact as the withholding of that which is not stated makes that is stated absolutely false.
2. The representation or assertion alleged to be false must be of a fact. A mere expression of opinion, puffery or flourishing description does not constitute fraud.
3. The representation or statement must have been made (a) knowingly or (b) without belief in its truth or (c) recklessly, carelessly whether it be true or false. In (a) and (b), there seems to be no difficulty since fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth. However, with regard to reckless misstatement it may appear difficult to say whether it amounts to fraud because the person making such statement does not himself definitely know that the statement is false. But if we carefully look into it we find that it does amount to fraud. Though the person making it is not sure of the truth of the statement yet he represents to the other party as if he is absolutely certain about its truth.
4. The representation, statement, or assertion must have been made with the intention of inducing the other party to act upon it. For fraud to exist the intention of misstating the facts must be to cause the other party to enter into an agreement.
5. The representation must in fact deceive. It has been said that a deceit which does not deceive is not a fraud. A fraud or misrepresentation, which does not cause the consent to a contract of the party on whom such fraud is practised or to whom such misrepresentation was made, does not render a contract voidable.
6. The party subjected to fraud must have suffered some loss. It is a common rule of law that there is no fraud without damages. As such a fraud without damage does not give rise to an action of deceit.

Example: A informs B fraudulently that A's estate is free from encumbrance. B therefore buys the estate. The estate in fact is subject to a mortgage. B may either avoid the contract or may insist on its being carried out and the mortgage deed redeemed.

Notes

4.5 Meaning of Misrepresentation (Ss. 18-19)

Misrepresentation is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation. Like fraud, misrepresentation is an incorrect or false statement but the falsity or inaccuracy is not due to any desire to deceive or defraud the other party. Such a statement is made innocently. The party making it believes it to be true. In this way, fraud is different from misrepresentation. The case of misrepresentation may be classified into the following three groups:

(i) The positive assertion in a manner not warranted by the information of the person making it, of that which is not true though he believes it to be true.

(ii) Any breach of duty which without an intent to deceive gives an advantage to the person committing it (or anyone claiming under him) by misleading another to his prejudice or to the prejudice of anyone claiming under him.

(iii) Causing however innocently a party to an agreement to make a mistake as to the substance of a thing which is the subject of the agreement.

Example:

(i) A chartered a ship to B which was described in the 'Charter Party' and was represented to him as being not more than 2,800 tonnage registered. It turned out that the registered tonnage was 3,045 tons. A refused to accept the ship in fulfillment of the charter party. He would be entitled to avoid the charter party by reason of the erroneous statement as to tonnage.

(ii) A, by a misrepresentation leads B erroneously to believe that 500 kilos of indigo are made annually at A's factory. B examines the account of the factory, which show that only 400 kilos of indigo have been made. After this B buys the factory. The contract is not voidable an account of A's misrepresentation.

(iii) H sold W with all faults certain animals which were suffering from some fever, the fact of which was known to him but he did not disclose to W, it was held that there was no fraud (*Ward v. Hobbs* (1878) A C 13).

(iv) A sold to B by auction a horse which A knew to be unsound. A said nothing to B about the horse's unsoundness. This was held not to be a fraud.

Silence may in itself be equivalent to speech. Silence may in itself amount to fraud where the circumstances are such that "silence is in itself equivalent to speech".

Example:

(i) Where B says to A, "if you do not deny it I shall assume that the car does not overheat" A says nothing. Here A's silence is equivalent to speech.

(ii) A prospectus issued by a company did not refer to the existence of a document disclosing liabilities. The impression thereby created was that the company was a prosperous one which actually was not the case. Held, the suppression of truth amounted to fraud [*Peek v. Gurney* (1873) 6 H.L.377].

However, a mere expression of opinion, puffery or flourishing description does not amount to a fraud.

Example:

(i) A, a seller of a vintage car says that the car is a 'beauty'. It is merely A's opinion. But in case he says that the car is worth ₹ 5 lakhs whereas he paid only ₹ 2 lakhs for it, then he has misstated a fact which may amount to fraud or simple misrepresentation.

Notes

(ii) A company issued a prospectus giving false information about the unbounded wealth of Nevada. A person buys shares on the faith of such an information. Later he wants to avoid the contract. He can avoid the contract since the false representation in the prospectus amounts to fraud (Reese River Silver Minning Co. v Smith (1869) L.R. 4 H. [664]).

Consequences of fraud and misrepresentation [s.19]. The party aggrieved or wronged has two remedies viz, (i) he can avoid the performance of the contract (ii) he can insist that the contract shall be performed and that he shall be put in the position in which he would have been if the representation made had been true. In case of fraud, he has an additional remedy, i.e., he can sue for damages.

Exceptions to the principle that the party aggrieved or wronged by misrepresentation cannot claim damages. The directors of a company are liable in damages under s.62 of the Companies Act, 1956, even for misstatements, i.e., misrepresentation in the prospectus issued by the company inviting public for subscription. Also where there exists a confidential relationship between the parties (such as solicitor and client), and negligent representation is made by one to the other then the aggrieved party may claim damages.

Fraud and misrepresentation. The following are the points of difference between the two:

1. In case of fraud, the party making false or untrue representation makes it with the intention to induce the other party to enter into a contract. Misrepresentation, on the other hand, is innocent i.e., without any intention to deceive or to gain an advantage.
2. Both fraud and misrepresentation make a contract voidable at the option of the party wronged. But in case of fraud, the party defrauded gets the additional remedy of suing for damages caused by such fraud. In case of misrepresentation, generally, the only remedies are rescission and restitution.
3. In case of fraud, the defendant cannot take the plea that the plaintiff had the means of discovering the truth or could have done so with ordinary diligence. In case of misrepresentation, it could be a good defense.

Cases of fraud or misrepresentation in which the contract is not voidable. There are two exceptions to the principle that the party aggrieved or wronged can avoid the contract. Firstly, where the party whose consent was caused by fraud or misrepresentation had the means of discovering the truth with ordinary diligence. Secondly, where the party after becoming aware of the fraud or misrepresentation takes a benefit under the contract or in some way affirms it.

4.6 Meaning of 'Mistake' [Ss.20-21]

Mistake may be defined as an erroneous belief on the part of the parties to the contract concerning something pertaining to the contract. For example, A agrees to buy from B a certain house. It turns out that the house had been destroyed by fire before the time of the bargain though neither party was aware of the fact. The agreement is void. A cannot insist for possession of the house. The agreement is void as there is a mistake on the part of both the parties about the existence of the subject matter.

Different kinds of mistake. Broadly, there are two kinds of mistake: (i) Mistake of fact and (ii) Mistake of law. Further mistake of fact may be either: (a) Bilateral or (b) Unilateral. The mistake of law may be (a) mistake of law of the land and (b) mistake of foreign law. When both the parties to the agreement are under a mistake of fact essential to the agreement, the mistake is called a bilateral mistake and the agreement is void. For example, A agrees to sell to B a specific cargo of goods supposed to be on its way from London to Mumbai. It turns out that before the day of the bargain the ship conveying the cargo had been cast away and the goods lost. Neither party was aware of the facts. The agreement is void.

Some typical cases of bilateral mistake invalidating the agreement. There may be a mistake concerning subject matter as to its (i) existence, (ii) identity, (iii) title, (iv) quantity, (v) price.

Notes

Example:

(i) A, who owns two fiat cars, offers to sell his 'White fiat' for ₹ 80,000. B accepts the offer thinking A is selling his 'Brown Fiat'. There is a mistake as to the identity of the subject matter.

(ii) P wrote to H inquiring the price of rifle of a particular make and suggested that he might buy as many as 30. On receipt of the information he telegraphed, "send three rifles". But because of the mistake of the telegraph authorities the message transmitted was "send the rifles". H dispatched 30 rifles. Held, there was no contract between the parties who were labouring under a mistake as to the quantity of the subject matter (*Henkel v. Pape* (1870) 6 Ex.7).

(iii) Where a contract of lease of a house was agreed to at a lease amount of ₹ 2300 but in the written agreement the figure 3200 was inserted by mistake the contract was held to be void.

An erroneous opinion, however, as to the value of thing which forms the subject matter of the agreement is not to be deemed a mistake as to a matter of fact.

Example: A buys an article thinking it is worth ₹ 10,000 while it is actually worth ₹ 5,000 only. Later he wants to avoid the agreement on the ground of mistake as to the price of the subject matter. The agreement cannot be avoided on the ground of mistake. It is only erroneous opinion as to the value of the subject matter and is not deemed a mistake as to a matter of fact.

4.7 Meaning and Effect of 'Unilateral Mistake'

There is a unilateral mistake where only one party to a contract is under a mistake as to a matter of fact. Generally speaking, such a contract is not invalid. Thus, where a person due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must bear the consequences.

Example: A sold rice to B by sample, and B thinking that they were old rice, purchased them. In fact, the rice were new. B cannot avoid the contract.

Exceptional cases in which agreement is void even when there is a unilateral mistake.

Firstly, where the unilateral mistake is as to the nature of the contract. Thus, in *Foster v. Mackinnon* (1869) LR 4 C.P. 704 an old illiterate man was made to sign a bill of exchange by means of a false representation that it was a guarantee. Held, the contract was void. The old man did not intend to enter into the contract relating to bill of exchange but through the fault of another and without any fault of his own made a mistake as to the nature of the contract. ***Secondly***, where the unilateral mistake is as to the identity of the person contracted with. Where A intends to contract with B but by mistake enters into a contract with C believing him to be B, the contract is void. In *Cundy v. Lindsay and Co.* (1878) 3 App. Cas. 459, one Blenkarn, knowing that Blenkiron & Co. were the reputed customers of Lindsay & Co. ordered some goods from Lindsay & Co. by imitating the signature of Blenkiran. These goods were then sold by Blenkarn to Cundy, an innocent purchaser. In a suit by Lindsay & Co. against Cundy for recovery of goods it was held that as Lindsay & Co. never intended to contract with Blenkarn there was no contract between them and as such even an innocent purchaser of the goods from Blenkarn did not get a good title and must return them or pay their price to Lindsay & Co. Similarly, in *Lake v Simmons* (1927) A.C.487, a lady X induced Y to deliver possession of two pearl necklaces falsely representing that she was the wife of baron Z and that she wanted them to be shown to her husband for approval. Held, Y intended to contract only with the wife of the baron and not with X herself. Hence the contract was void and X could not convey any title even to a bona fide buyer.

Notes

Example: A man, N called in person at a Jeweller's shop and chose some jewels which the jeweller was prepared to sell him as a casual customer. He tendered in payment a cheque which he signed in the name G – a person with credit. Thereupon N was allowed to take away the jewels which N pledged with B who took them in good faith. Here the contract between N and the jeweller is valid. The pledgee B has a good title. Although the jeweller believed the person to whom he was handing over the jewels was G, he in fact contracted to sell and deliver to the person who came into his shop.

Thirdly, a contract may be avoided where there is a unilateral mistake as to quality of performance.

Example: A held an auction for the sale of some lots of hemp and some lots of tow. B thinking that hemp was being sold, bid for a lot of tow for an amount which was out of proportion to it, and was only a fair price for hemp. B could avoid the contract.

4.8 Mistake of Law

It may be (i) mistake of law of the land, or (ii) mistake of foreign law. In the first case, the rule is "Ignorantia juris non-excusat".

Meaning of "ignorantia juris non-excusat". It means ignorance of law is no excuse. A contract is not voidable because it was caused by a mistake as to any law in force in India. Thus, where A and B make a contract grounded on the erroneous belief, that a particular debt is barred by the Limitation Act; the contract is not voidable. (s.21) Further, "A mistake as to a law not in India has the same effect as a mistake of fact".

Mistake of foreign law. The above maxim – "ignorance of law is no excuse" is inapplicable to foreign law. The mistake of foreign law is to be treated as a mistake of fact.

Consequences of mistake on contracts. Mistake renders the contract void and as such in case of a contract which is yet to be performed the party complaining the mistake may repudiate it, i.e., need not perform it. If the contract is executed the party who received any advantage must return it or make compensation for it as soon as the contract is discovered to be void.

Task Peter, by way of misrepresentation, leads Deepak erroneously to believe that 100 quintals of indigo are made annually at Peter's factory, Deepak examines the accounts of the factory and finds that only 50 quintals of indigo have been made. Afterwards, Deepak buys the factory. Deepak now wants to avoid the contract on the ground of misrepresentation. Advise him giving reasons.

Differences between Coercion and Undue Influence

Coercion	Undue Influence
Consent obtained by committing or threatening to commit an act forbidden by law.	Consent obtained from denomination of the will of the other
Physical character. It involves mostly use of physical or violent force	Use of moral Force/ Pressure to obtain consent .
Directed against a person or his property	Threat against person himself and not against his property
No relationship need to exist b/w parties	Some sort of relationship b/w the parties to contract
May be committed outside India	Should have been committed in India if it is to be taken into notice of Indian Law

Notes

Differences between Fraud and Misrepresentation

Fraud	Misrepresentation
Implies on intention to deceive, hence it is intentional or willful wrong	Is an innocent wrong without any intention to deceive. The person making the statement believes it to be true.
A civil wrong which entitles a party to claim damages in addition to the right to rescind the contract.	Gives only the right to rescind the contract and there can be no suit for damages.
Fraud, In certain cases is a punishable offence under Indian penal code.	In case of misrepresentation, the fact that the aggrieved party had the means of discovering the truth with ordinary diligence, the contract does not become voidable. But where consent to an agreement is caused by active fraud, the contract is voidable even though the party defrauded had the means of discovering the truth. However where the silence amount to fraud, the contract is not voidable if the deceived party had the means of discovering the truth.

Caselet

Kezia's Case

Kezia's case are in relation to the Theft Act and Fraud, Kazia has been charged with Theft of the death certificate and with Fraud by misrepresentation. What I have to discover are the reasons she has been convicted of the above charges. In order to determine Kezia's position and the legal consequences which she has been charged with we first need to identify and explain the relevant law. First of all I shall determine actus reus of theft, which consist of "property", "appropriation" and "belonging to another". Then we shall look at mens rea, intention of permanent deprivation and dishonesty which would be applicable to her charges.

Theft is an offence under s1 of the Theft Act 1968, which says, "A person is guilty of theft if he dishonestly appropriates property belonging to another with the intention of permanently depriving the other of it: and thief and steal shall be construed accordingly."

Any assumption by a person of the rights of an owner amounts to an appropriation, and this includes where he has come by the property (innocently or not) without stealing it, any later assumption of right to it by keeping or dealing with it as owner

Kezia's actions formed appropriation at the time when she picked up the certificate of a colleague, at first instance she wants to put it somewhere safe but then decide to put it in her brief case and believes she'll be able to put it back before her colleague returns. There is the mental element of using the property of another to use it, enjoy and abuse it.

The certificate indisputably is a property of her colleagues as accordance to s.4 property includes money and all other property, real or personal, including things in action and other intangible property. S.5 of Theft act gives five situation where property belongs to another but the germane to the Kezia case which would be uncovered by the courts is S5 (1) which says, property shall be regarded as belonging to any person having possession or control of it, or having any proprietary rights. This section illuminates that it is not required that property should be owned by the person whom it is appropriated, mere possession or control is enough. An example would be that A loans a book to B and B showing it to C and D steals it. In this situation D has stolen the book from C who was in control of it, and B who had the possession and A, who had the proprietary interest as to ownership of the book. The courts will determine whether the certificate was owned by the colleague at the time of appropriation as a person cannot steal property that is not owned by another.

Contd....

Notes

Property which has at one time been owned may become ownerless by abandonment, but abandonment is not something to be lightly inferred; property is abandoned only when the owner is indifferent to any future appropriation of the property by others. So this mean that property would not be considered abandoned because the owner has lost it and has given up the search for it. The more valuable the property, the less likely it is that the owner has abandoned the hope of ever seeing it again

So in relation to Kezia case, it is most likely that death certificate comes under a valuable property hence her colleagues had the ownership in it. And when Kezia takes the certificate this verify she has possession or either control of it. This further authenticates that, when she has the intention to use the certificate as a proof of evidence to attain extension for her assignment.

Any assumption by a person of the rights of an owner would amount to an appropriation in accordance to s3(1) of the Theft Act 1968, so in relation to Kezia taking the death certificate from her desk would amount to theft, but one could say she took it innocently at first instance as to take care of it, but S3 (1) also states that …where a person has come to by the property (innocently or not) without stealing it, any later assumption of right to it by keeping or dealing with it as an owner would also amount to appropriation. This means that Kezia taking the certificate does amount to theft as she had the intention of using the certificate in bid to get an extension for her assignment under mitigating circumstances. She clarifies her intention further, when she fills in the mitigating form where she writes that she'll send in evidence of documentation to support her mitigation request.

In Gomez (1991) and Hinks (2001) further confirmed that the word appropriation was taken to be neutral word with the meaning any assumption by a person of the rights of an owner given in S3 (1) of Theft Act 1968 would be considered theft. In the case of Morris (1983) it was stated that, there had to be an element of adverse interference with or usurpation of any of the rights of the owner

At this instant we have comprehended that the certificate was property of her colleague and Kezia has appropriated it, the next element must be proved is Mens rea of Theft, dishonesty and intention to permanently to deprive; which would illustrate Kezia's state of mind.

There has been a partial definition of dishonesty in the 1968 Act as there has been left some discretion to the court. The s2 (1) gives three situations where a defendant is not deemed dishonest:

1. If he appropriates the property in the belief that he has in law the right to deprive the other of it, on behalf of himself or of a third person(S.2 (1)(a)); or
2. If he appropriates the property in the belief that he would have the other's consent if the other knew of the appropriation and the circumstances of it; (S.2 (1)(b)) or
3. (Except where the property came to him as trustee or personal representative) if he appropriates the property in the belief that the person to whom the property belongs cannot be discovered by taking reasonable steps (S.2 (1)(c))

S2 (2) states that a person appropriation of property belonging to another may be dishonest even though he is willing to pay for the property

As the above examples do not fall within Kezia case then the court would look at common law to decide if Keiza has been dishonest. Lord Lane in R V Gosh (1982) said,

"... A jury first of all decide whether according to the ordinary standards of reasonable and honest person people what was done was dishonest."

Notes

4.9 Summary

- Coercion is (i) the committing or threatening to commit any act forbidden by the Indian Penal Code or (ii) 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. [s.15].
- When consent to an agreement is caused by coercion the agreement is voidable at the option of the party whose consent was so obtained. Thus, the aggrieved party can have the contract set aside if he so desires otherwise the contract is a valid one. However, a person, to whom money has been paid or anything delivered under coercion, must repay or return it to the other party (s.72).
- A contract is said to be induced by undue influence where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.
- The burden of proving that the contract is not induced by undue influence lies on the party who is in a position to dominate the will of the other. Thus, in cases (above given) where undue influence is presumed the onus of proof lies on parent, guardian, doctor, spiritual guru, lawyer, trustee. On the other hand, in relationships where undue influence is not presumed the party alleging undue influence must prove that it existed.
- The representation or assertion alleged to be false must be of a fact. A mere expression of opinion, puffery or flourishing description does not constitute fraud.
- The representation or statement must have been made (a) knowingly or (b) without belief in its truth or (c) recklessly, carelessly whether it be true or false. In (a) and (b), there seems to be no difficulty since fraud is proved when it is shown that a false representation has been made knowingly or without belief in its truth. However, with regard to reckless misstatement it may appear difficult to say whether it amounts to fraud because the person making such statement does not himself definitely know that the statement is false. But if we carefully look into it we find that it does amount to fraud. Though the person making it is not sure of the truth of the statement yet he represents to the other party as if he is absolutely certain about its truth.
- The representation, statement, or assertion must have been made with the intention of inducing the other party to act upon it. For fraud to exist the intention of misstating the facts must be to cause the other party to enter into an agreement.
- The case of misrepresentation may be classified into the following three groups: (i) The positive assertion in a manner not warranted by the information of the person making it, of that which is not true though he believes it to be true. (ii) Any breach of duty which without an intent to deceive gives an advantage to the person committing it (or anyone claiming under him) by misleading another to his prejudice or to the prejudice of anyone claiming under him. (iii) Causing however innocently a party to an agreement to make a mistake as to the substance of a thing which is the subject of the agreement.
- There is a unilateral mistake where only one party to a contract is under a mistake as to a matter of fact. Generally speaking, such a contract is not invalid. Thus, where a person due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must bear the consequences.

4.10 Keywords

Misrepresentation: It is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation.

Notes

Mistake of foreign law: The above maxim – "ignorance of law is no excuse" is inapplicable to foreign law. The mistake of foreign law is to be treated as a mistake of fact.

Mistake: May be defined as an erroneous belief on the part of the parties to the contract concerning something pertaining to the contract.

Undue influence: Consists in the improper exercise of power over the mind of one of the contracting parties by the other.

4.11 Self Assessment

Fill in the blanks:

1. For a contract to be valid it is not only necessary that the parties ..... but also that they consent freely.
2. ..... consists in the improper exercise of power over the mind of one of the contracting parties by the other.
3. An ..... caused by undue influence is voidable at the option of the party whose consent was obtained by undue influence.
4. In ....., the rate of interest being high, or that the borrower is in urgent need of money is not an evidence of undue influence.
5. ..... is also known as simple misrepresentation whereas fraud is known as fraudulent misrepresentation.
6. The directors of a company are liable in damages ..... Act, 1956, even for misstatements, i.e., misrepresentation in the prospectus issued by the company inviting public for subscription.

4.12 Review Questions

1. "It is not only the consent but free consent of the parties which is necessary for making the contract binding". Explain.
2. What is coercion? State its effect on the validity of a contract.
3. What is undue influence? When is it presumed as regards persons in particular relationships?
4. On whom does lie the burden of proving that contract (i) was, or (ii) was not induced by undue influence?
5. What is fraud? What are the essential elements or conditions necessary for its existence?
6. "An attempt to deceive which does not deceive is no fraud". Comment.
7. What is "mistake" as it affects the validity of a contract? What are the consequences of a mistake on contracts?
8. What is meant by 'unilateral mistake'.

Answers: Self Assessment

1. consent
2. undue influence
3. agreement
4. money lending transactions
5. Misrepresentation
6. under s.62 of the Companies

Notes

4.13 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S .S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

Unit 5: Discharge of Contract

Notes

CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain meaning of performance contract
- Discuss different modes of discharge of contract

Introduction

In last unit you have studied about the free consent. As you all come to know that the consent of the offeree to the offer by the offeror is necessary. It is essential to the creation of a contract that both parties agree to the same thing in the same sense. When two or more persons agree upon the same thing in the same sense they are said to consent. Coercion is the committing or threatening to commit any act forbidden by the Indian 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. Now this provides you brief description of performance contracts and different modes of Discharge of contract.

Notes

5.1 Meaning of Performance of Contract

A contract creates obligations. 'Performance' of contract means the carrying out of obligations under it. The parties to contract must either perform or offer to perform their respective promises unless such performance is dispensed with or excused under the provisions of the Indian Contract Act, or some law (s.37).

5.1.1 Meaning of Offer to Perform

It may happen that the promisor offers performance of his obligation under the contract at the proper time and place but the promisee refuses to accept the performance. This is called as 'Tender' or 'Attempted Performance'. If a valid tender is made and is not accepted by the promisee, the promisor shall not be responsible for non-performance nor shall he lose his rights under the contract. However, since the tender is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity to see that the thing offered is the thing contracted for.

5.1.2 Who must Perform the Promise under a Contract?

The promise may be performed by promisor himself or his agent or by his legal representative. (i) In case, there was an intention of the parties that the promise must be performed by the promisor himself, such promise is to be performed by him only. Thus, where A promises to paint a picture for B, then A must perform this promise personally. (ii) If there is no such intention of the parties, then the promisor may employ a competent person to perform the promise. If A has promised to deliver some items of grocery to B, A may perform this promise either personally delivering the items to B or causing it to be delivered to B through someone. (iii) In case of death of the promisor, the legal representative must perform the promise unless a contrary intention appears from the contract. A promises to deliver goods to B on a certain day on payment of ₹ 1,000. A dies before that day. A's legal representatives are bound to deliver the goods to B, and B is bound to pay ₹ 1,000 to A's representatives. (iv) Where, however, a contract involves personal skill, then it comes to an end with the death of the promisor. Thus, where A promises to paint a picture for B by a certain day but dies before that day, the contract cannot be enforced by A's representatives or by B.

Performance of joint promises. The Act provides rules for devolution of joint liabilities and rights.

Devolution of joint liabilities. Section 42 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfil the promise. In the event of death of any of them, his representative jointly with the survivor or survivors and in case of the death of all promisors, the representatives of all of them jointly must fulfil the promise.

Liabilities of joint promisors. When two or more persons make a joint promise, the promisee may, in the absence of an express agreement to the contrary, compel anyone or more of such joint promisors to perform whole of the promise. Thus, the liability of joint promisors is joint as well as several [s.43]. Thus, s. 42 makes all the joint promisors liable on the promise jointly, whereas s. 43 provides that any one of the joint promisors may be compelled to perform.

Example: A, B and C jointly promise to pay D ₹ 3,000. D may compel either A, or B or C or any two of them to pay him ₹ 3,000.

Right of contribution amongst joint promisors. Where, a joint promisor has been compelled to perform the whole promise, he may compel every other joint promisor to contribute equally

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with himself to the performance of the promise, unless a contrary intention appears from the contract. If any one of the joint promisors makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares.

Example: (i) A, B and C are under a joint promise to pay D ₹ 3,000. A is compelled to pay the whole amount of ₹ 3,000. A can recover ₹ 1,000 each from B and C.

(ii) A, B and C jointly promise to pay D a sum of ₹ 3,000. C is compelled to pay the whole amount of ₹ 3,000. A is insolvent, but his assets are sufficient to pay ½ of his debts. C is entitled to receive ₹ 500 from A's estate and ₹ 1,250 from B.

(iii) A, B and C are under a joint promise to pay D ₹ 3,000. C is unable to pay anything and A is compelled to pay the whole amount of ₹ 3,000. A is entitled to receive ₹ 1,500 from B.

Release of joint promisor. Where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor or promisors, neither does it free him from the responsibility to the other joint promisor or promisors [s. 44].

Devolution of joint rights (s. 45). When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests with all the joint promisees and after the death of any of them, with the representatives of such deceased promisee jointly with the survivor or survivors; and after the death of the survivors also, with the representatives of all jointly. Thus, unlike the case of joint promisors whose liability is joint as well as several, the right of the promisees is only joint and thus any one of them cannot enforce performance unless so agreed.

Example: A, in consideration of ₹ 5,000 lent to him by B and C, promises B and C jointly to repay them that sum with interest on a day specified. B dies. The right to claim performance rests with B's representative jointly with C during C's life, and after C's death with the representatives of B and C jointly.

5.1.3 Contracts which need not be Performed

There are certain situations where contracts need not be performed. These are (i) The parties may mutually agree to substitute the original contract by a new one or to rescind it or alter it. A owes money to B under a contract. It is agreed between A, B and C that B shall henceforth accept C as his debtor, instead of A. The old debt of A to B is at an end and a new debt from C to B has been contracted. (ii) The promisee may dispense with or remit wholly or in part the performance of the promise made to him or extend the time for such performance or accept any satisfaction for it. For instance, A promises to paint a picture for B. Later, B forbids A to do so. A is no longer bound to perform the promise. Or C owes D ₹ 5,000. C pays D ₹ 2,000 and D accepts it in satisfaction of his claim on C. This payment is a discharge of the whole claim. (iii) The person at whose option the contract is voidable because of undue influence, coercion, fraud or misrepresentation can rescind it. (iv) The promisee neglects or refuses to afford the promisor reasonable facilities for the performance of his promise. For instance, A contracts with B to repair B's house. B neglects or refuses to point out to A the places in which his house requires repair. A need not perform.

Task

Discuss Performance Contract by providing relevant examples.

Notes

5.2 Rules regarding the Time, Place and Manner of Performance of Contracts [Ss.46-50]

These rules are: (i) Where the time for performance has been specified and the promisor has undertaken to perform it without application by the promisee, the promisor must perform on the day fixed during the usual business hours and at the place at which the promise ought to be performed. A promises to deliver goods to B at his warehouse on 15th July. A offers the goods at B's warehouse but after the usual hours for closing it. The performance of A is not valid. (ii) Where the time of performance is not specified and the promisor agrees to perform without a demand from the promisee, the performance must be made within a reasonable time. What is a reasonable time is, in each particular case, a question of fact. (iii) Where a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, the promisee must apply for performance at a proper place and within the usual business hours. What is a proper time and place is, in each particular case, a question of fact. (iv) When a promise is to be performed without application by the promisee and no place is fixed for its performance, the promisor must apply to the promisee to appoint a reasonable place for the performance of the promise, and perform it at such place. A undertakes to deliver 1,000 kilos of Jute to B on a fixed day. A must apply to appoint a reasonable place for the purpose of receiving it and must deliver it to him at such place. (v) The performance of any promise may be made in any manner or at any time which the promisee prescribes or sanctions.

Examples:

(i) A owes B ₹ 2,000. B accepts some of A's goods in deduction of the debt. The delivery of the goods operates as a part payment.

(ii) B owes A ₹ 2,000. A desires B to pay the amount to A's account with C, a banker. B, who also banks with C orders the amount to be transferred from his account to A's credit and this is done by C. Afterwards and before A knows of the transfer, C fails. There has been a good payment by B.

(iii) A, a shopkeeper desires B, a customer who owes him ₹ 1,000 to send him a cheque for ₹ 1,000 by post. The debt is discharged as soon as B puts into the post a letter, containing the cheque addressed to A.

Reciprocal Promises [Ss.51-54]

Reciprocal promises means a promise in return for a promise. Thus, where a contract consists of a promise by one party (to do or not to do something in future) in consideration of a similar promise by other party, it is a case of reciprocal promises. Reciprocal promises may be divided into three groups: (i) Mutual and dependent, (ii) Mutual and independent, and (iii) Mutual and concurrent.

Rules concerning performance of different kinds of reciprocal promises. These are:

1. In the case of mutual and dependent promises, the performance of one party depends upon the prior performance of the other party. If the promisor, who must perform, fails to perform it, he cannot claim the performance of the reciprocal promise. On the other hand, he must compensate the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.

Examples:

(i) A contracts with B to execute certain builder's work for a fixed price, B supplying the necessary timber for the work. B refuses to furnish any timber and the work cannot be

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executed. A need not perform the contract. B is bound to compensate for any loss caused to A by the non-performance of the contract.

(ii) X promises Y to sell him 100 units of a commodity, to be delivered next day and Y promises X to pay for them within a month. X does not deliver according to his promise, Y's promise to pay need not be performed. Also X must compensate Y.

2. In the case of mutual and independent promises, each party must perform his promise without waiting for the performance or readiness to perform on the part of the other. A promises B to deliver him goods on 10 July and B in turn promises to pay the price on 6 July. B's paying the price is independent of A's delivering the goods and even if B does not pay the price on 6 July, A must offer the delivery of the goods on 10 July. A can, of course, sue B for price and damages.

3. In the case of mutual and concurrent promises, the performance is to be simultaneous. Thus, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.

Examples:

(i) L and M contract that L shall deliver goods to M to be paid by installments, the first instalment to be paid on delivery. L need not deliver, unless M is ready and willing to pay for the goods on delivery. And M need not pay for the goods unless L is ready and willing to deliver them on payment.

(ii) R and S contract that R shall deliver goods to S at a price to be paid by installments, the first instalment to be paid on delivery. R need not deliver, unless S is ready and willing to pay the first instalment on delivery. And S need not pay the first instalment, unless R is ready and willing to deliver the goods on payment of the first instalment.

Reciprocal promise to do things legal and also other things illegal. Section 57 provides that where persons reciprocally promise, firstly, to do certain things which are legal and secondly, under specified circumstances, to do certain things which are illegal, the first set of promises is a contract but the second set is a void agreement.

Example: X and Y agree that X shall sell Y a house for ₹ 1,00,000 but that if Y uses it as a gambling house, he shall pay X ₹ 5,00,000 for it. The first set of reciprocal promises, namely, to sell the house and pay ₹ 1,00,000 for it is a contract. The second set is for unlawful object, that Y may use the house as a gambling house and is a void agreement.

5.3 Appropriation of Payments [Ss. 59-61]

Appropriation of payments means application of payments. When a debtor owes several debts in respect of which the payment must be made (to the same creditor), the question may arise as to which of the debts, payment is to be appropriated. In England, the law on the subject was laid down in Clayton's case. The rule in Clayton's case was stated as : "If a man owes another two debts upon distinct causes, and pays him a sum of money, the payer has a right to say to which account the money so paid is to be appropriated".

In India, the rules regarding appropriation of payments are contained in Ss. 59 to 61 which, in fact, have adopted with certain modifications the rules laid down in Clayton's case. The provisions of these sections are summarised hereunder:

Rule 1 – Appropriation by debtor (s. 59) Where a debtor, owing several distinct debts to one person, makes a payment to him with express intimation that the payment is to be applied to the discharge of some particular debt, the payment, if accepted, must be applied to that debt. Where,

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however, no express intimation is given but the payment is made under circumstances implying that it should be appropriated to a particular debt, the payment, if accepted, must be applied to that debt.

Example:

(i) A owes B, among other debts, ₹ 1,000 upon a promissory note which falls due on 1st June. He owes B no other debt of that amount. On the 1st June A pays B ₹ 1,000. The payment is to be applied to the discharge of the promissory note.

(ii) A owes B among other debts, the sum of ₹ 974. B writes to A and demand payment of his sum. A sends to B ₹ 974. This payment is to be applied to the discharge of the debt of which B had demanded payment.

Rule 2 – Appropriation by creditor (s.60). Where the debtor has omitted to intimate and there are no other circumstances indicating to which debt payment is to be applied, the creditor may apply it at his discretion to any lawful debt actually due and payable to him by the debtor. The amount, in such a case, can be applied even to a debt which has become 'time-barred'. However, it cannot be applied to a disputed debt.

Example: A obtains two loans of ₹ 20,000 and ₹ 10,000, respectively. Loan of ₹ 20,000 is guaranteed by B. A sends the bank ₹ 5,000 but does not intimate as to how it is to be appropriated towards the loans. The bank appropriates the whole of ₹ 5,000 to the loan of ₹ 10,000 (the loan not guaranteed). The appropriation is valid and cannot be questioned either by A or B.

Rule 3 – Where neither party appropriates (s.61). Where neither party makes any appropriation, the payment is to be applied in discharge of the debts in order of time, including time-barred debts. If the debts are of equal standing the payment is to be applied proportionately. This rule is generally applicable in case of running accounts between two parties, money being paid and withdrawn from time to time from the account, without any specific indication as to appropriation of the payment made. In such a case debits and credits in the accounts will be set up against one another in order of their dates, leaving only final balance to be recovered from the debtor by the creditor.

Rule in Hallett's Estate Case. The rule in Hallett's Estate Case is an exception to the above Rule 3. The rule applies where a trustee had mixed up trust funds with his own funds. In such a case, if the trustee misappropriates any money belonging to the trust, the first amount so withdrawn by him would be first debited to his own money and then to the trust funds. Similarly, any deposits made by him would first be credited to trust fund and then to his own fund, whatever be the order of withdrawal and deposit.

Example: A trustee deposits ₹ 10,000 being trust money with a bank and subsequently deposits ₹ 50,000 of his own in the same account. Thereafter, he withdraws ₹ 10,000 from the bank and misappropriates it. The said withdrawal will not be appropriated against the trust amount of ₹ 10,000 but only against his own deposit though this was made later than the first deposit thus leaving the trust fund intact.

Assignment of Contracts

Assignment means transfer. When a party to a contract transfers his right, title and interest in the contract to another person or persons, he is said to assign the contract. Assignment of a contract can take place by (i) operation of law or (ii) an act of parties. The example of assignment by operation of law is by insolvency or death of the party to the contract. In the case of insolvency the Official Receiver (or Official Assignee) acquires the interest in the contract. In the case of death, the legal representative of the deceased, who was a party to the contract, gets the interest

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in the contract. In this type of assignment, the parties to the contract are not active; it is the law which operates. In the case of assignment by act of parties, the parties themselves make the assignment.

The rules regarding assignment of contracts are:

Firstly, the obligations or liabilities under a contract cannot be assigned except by novation. Thus, if A owes B ₹ 10,000, he cannot transfer his obligation to pay to C and compel B to collect money from C. However, if the promisee agrees to such an assignment he will be bound by it. In such a case a new contract is substituted for the old one. This is called 'novation'. Thus, in the above example, if B agrees to accept payment from C, the assignment will be valid and A shall stand discharged of his obligation to pay.

Secondly, rights and benefits under a contract may be assigned. For example, where A owes B ₹ 10,000, B may assign his right to C. However, a right or benefit under a contract cannot be assigned if it involves personal skill, ability, credit or other personal qualifications. For example, a contract to paint a picture personally cannot be assigned.

Thirdly, the rights of a party under a contract may amount to actionable claims which can be assigned by a written document. Notice of the assignment is to be given to the debtor to make it valid.

5.4 Different modes of Discharge of Contracts [Ss.73-75]

A contract may be discharged by (i) performance; (ii) tender; (iii) mutual consent; (iv) subsequent impossibility; (v) operation of law; (vi) breach.

5.4.1 Discharge of Contracts by Performance or Tender

The obvious mode of discharge of a contract is by performances that is where the parties have done whatever was contemplated under the contract, the contract comes to an end. Thus, where A contracts to sell his car to B for ₹ 1,85,000, as soon as the car is delivered to B and B pays the agreed price for it, the contract comes to an end by performance. The tender or offer of performance has the same effect as performance. If a promisor tenders performance of his promise but the other party refuses to accept, the promisor stands discharged of his obligations.

5.4.2 Meaning of Mutual Consent (S. 62)

If the parties to a contract agree to substitute a new contract for it, or to rescind it or alter it, the original contract is discharged. A contract may terminate by mutual consent in any of the six ways viz. novation, rescission, alteration and remission, waiver and merger. Novation means substitution of a new contract for the original one. The new contract may be substituted either between the same parties or between different parties. A owes money to B under a contract. It is agreed between A, B and C that B shall henceforth accept C as his debtor instead of A. The old debt of A to B is at an end and a new debt from C to B has been contracted.

In order that the new contract is valid, it is essential to have the consent of all the parties, including the new one (s), if any. Also the contract which is substituted must be one capable of enforcement in law. Thus, where the subsequent agreement is insufficiently stamped, and, therefore, cannot be sued upon, novation does not become effective, that is, the original party shall continue to be liable.

Section 62 explains the effect of novation. The original contract stands discharged. There need not be any consideration for the new contract as the discharge of old contract is considered sufficient consideration for the new one. It is to be noted that novation must take place before the expiry of the time of the performance of the original contract.

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Example: A who owes B ₹ 2,00,000 enters into an arrangement with him thereby giving B a mortgage of his estate for ₹ 1,50,000. This arrangement constitutes a new contract and terminates the old one.

Rescission means cancellation of all or some of the terms of the contract. Where parties mutually decide to cancel all or some of the terms of the contract, the obligation of the parties thereunder terminates.

Alteration: If the parties mutually are to change certain terms of the contract, it has the effect of terminating the original contract. There is, however, no change in the parties.

Remission (s.63): It is the acceptance of a lesser sum than what was contracted for or a lesser fulfillment of the promise made. A owes B ₹ 5,000. A pays to B ₹ 1,000 and B accepts them in satisfaction of his claim on A. This payment is a discharge of the whole claim. It may be noted that the promisee may remit or give up a part of his claim and the promise to do so is binding even though there is no consideration for doing so.

Example: A owes B ₹ 5,000. A pays to B who accepts, in satisfaction of the whole debt, ₹ 2,000 paid at the time and place at which ₹ 5,000 were payable. The whole debt is discharged.

Waiver: It means relinquishment or abandonment of a right. Where a party waives his rights under the contract, the other party is released of his obligations. A promises to paint a picture for B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

Merger: A contract is said to have been discharged by way of merger where an inferior right possessed by a person coincides with a superior right of the same person. A, who is holding a certain property under a lease, buys it. His rights as a lessee vanish; they are merged into the rights of ownership which he has now acquired. The rights associated with lease were inferior to the rights associated with the ownership.

Task Ram owes B ₹ 7,000. Ram pays to Sahil who accepts in satisfaction of the whole debt ₹ 3000 paid at the time and place at which ₹ 7,000 were payable. Discuss the debt discharged or not?

5.5 Discharge of Contracts by Impossibility of Performance

A contract may be discharged because of impossibility of performance. There are two types of impossibility: (i) Impossibility may be inherent in the transaction (i.e., the contract), (ii) Impossibility may emerge later by the change of certain circumstances material to the contract.

Examples of Inherent Impossibility:

1. A promises to pay B ₹ 50,000 if B rides on a horse to the moon. The contract is void ab initio.
2. A agrees with B to discover treasure by magic. The agreement is void ab initio, as there is an impossibility inherent therein.

"Subsequent or supervening impossibility" as a mode discharge of contract (s.56). Where a contract originates as one capable of performance but later due to change of circumstances its performance becomes impossible, it is known to have become void by subsequent or supervening impossibility. The subsequent impossibility is known as 'Doctrine of Frustration' under the English law.

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Circumstances of supervening impossibility. A contract is deemed to have become impossible of performance and thus void under the following circumstances:

1. ***Destruction of the subject matter of the contract.*** Where the subject matter of a contract is destroyed for no fault of the promisor, the contract becomes void by impossibility of performance. Thus, where a music hall was agreed to be let out on certain dates, but before those dates it was destroyed by fire the owner was absolved from liability to let the building as promised (*Taylor v. Caldwell* (1863) 122 E R 299).

2. ***By the death or disablement of the parties.*** Where the performance of the contract must be executed personally by the promisor, his death or physical disability to perform shall render the contract void and thus exonerate him from the obligation.

Examples:

(i) A, a singer, agrees with B, to give performance at some particular theatre on a specified date. While on her way to theatre, A meets with an accident and is rendered unconscious. The agreement becomes void.

(ii) A contracts to act at a theatre for six months in consideration of a sum paid in advance by B. On several occasions A is too ill to act. The contract to act on those occasions becomes void.

However, in a case where the contract is not to be executed personally by the promisor, then death or physical disability does not render the contract void.

Example: X borrowed ₹ 10,000 from Y to be repaid by a certain date. X dies before the debt becomes due for repayment. X's legal representative shall be liable to pay the amount. Of course, the legal representative's liability is limited to the extent of the value of the assets inherited by him.

3. ***Subsequent illegality.*** Where by subsequent legislation, the performance of a contract is forbidden by law, the parties are absolved from liability to perform it. A contracts to supply B 100 bottles of whisky. Before the contract is executed, i.e., bottles supplied, dealings in all sorts of liquor are declared forbidden, the contract becomes void.

4. ***Declaration of war.*** If war is declared between two countries subsequent to the making of the contract, the parties would be exonerated from its performance. A contracts to take indigo for B to a foreign port. A's government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

5. ***Non-existence or non-occurrence of a particular state of things.*** When certain things necessary for performance cease to exist, the contract becomes void. A contracted to have a flat for viewing the coronation procession of the king. The procession had to be cancelled on account of king's illness. In a suit for recovery of the rent it was held that the contract became impossible of performance, and that the hirer need not pay the rent (*Krell v Henry* (1903) 2 K.B. 740).

Circumstances in which a contract is not discharged on the ground of subsequent impossibility. Except for the five cases mentioned above, subsequent impossibility does not discharge contracts. He who agrees to do an act must do it, unless absolutely impossible under the five cases mentioned above. There are at least five cases, where the performance is not excused on account of subsequent impossibility. These are:

1. ***Difficulty of performance.*** The mere fact that performance is more difficult or expensive or less profitable than the parties anticipated, does not discharge the contract. A promised to send certain goods from Mumbai to Antiwerp in September. In August, war broke out and shipping was not available except at very high rates. Held, the increase of freight rates did not excuse performance.

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2. ***Commercial impossibility.*** It means that if the contract is performed, it will result in a loss to the promisor. Commercial impossibility to perform a contract does not discharge the contract. A contract to lay gas mains is not discharged because the outbreak of war makes it expensive to procure the necessary materials [*M/s Alopi Pd. v. Union of India* (1960) S.C. 589].

3. The promisor is not exonerated from his liability if the third person, on whose work the promisor relied, fails to perform. Thus, a wholesaler's contract to deliver goods is not discharged because a manufacturer has not produced the goods concerned.

4. ***Strikes, lockouts and civil disturbances.*** Events like these do not terminate contracts unless there is a clause in the contract to that effect. A agreed to supply B certain goods to be produced in Algeria. The goods could not be produced because of riots and civil disturbances in that country. Held, there was no excuse for non-performance of the contract (*Jacob v. Credit Lyonnais* (1884) 12 Q.B.D 589].

5. ***Failure of one of the object.*** If the contract is made for several purposes, the failure of one of them does not terminate the contract. A agreed to let a boat to H to

   (a) view the naval review at the coronation and

   (b) to cruise around fleet. Owing to the king's illness the naval review was cancelled but the fleet was assembled and the boat could have been used to cruise round the fleet. Held, the contract was not discharged (*Herne Bay Steamboat C.v.Hutton* K.B 740).

Practical note for business executives. The business executives must note that the circumstances, on the basis of which a contract was entered into, may undergo radical changes, for no fault of either party as a result whereof the contract may even become impossible to perform as s.56 provides, inter alia, that the subsequent illegality or impossibility of the agreement renders it void. We have observed earlier that 'impossibility' means legal impossibility and does not cover commercial impossibility. Thus, a strike may create a difficult situation, but it does not amount to 'impossibility' in the legal sense. It is a case of mere commercial impossibility, which if the parties desire, may specifically provide for in the contract. Such a provision is contained in what is known as 'force majeure clause' in the contract. The effect of such a clause is to totally dispense with the performance of all obligations arising otherwise than under a contract.

Effect of supervening impossibility. There are three effects of supervening impossibility: (i) A contract to do an act which, after the contract is made becomes impossible or by reason of some event which the promisor couldn't prevent, unlawful, becomes void when the act becomes impossible or unlawful (s.56). (ii) Where a person has promised to do something which he knew, or with reasonable diligence, might have known and which the promisee did not know to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise (s.56). (iii) When a contract becomes void, any person who received any advantage under such contract is bound to restore it, or to make compensation for it to the person from whom he received it (s.65). Thus, where A contracts to sing for B at a concert for ₹ 1,000, which are paid in advance. A is too ill to sing. A must refund to B ₹ 1,000.

5.6 Discharge of a Contract by Operation of Law

Discharge by operation of law may take place in four ways:

1. ***By death.*** Death of the promisor results in termination of the contract in cases involving personal skill or ability.

2. ***By insolvency.*** The insolvency law provides for discharge of contracts under certain circumstances so where an order of discharge is passed by an insolvency court the insolvent stands discharged of all debts incurred previous to his adjudication.

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3. ***By merger.*** When between the same parties, a new contract is entered into, and a security of a higher degree or a higher kind is taken, the previous contract merges in the higher security. Thus a right of action on an ordinary debt would be merged in the right of suing on a mortgage for the same debt.

4. ***By the unauthorised alteration of terms of a written document.*** Where any of the parties alters any of the terms of the contract without seeking the consent of the other party to it, the contract terminates.

Further, Limitation Act, 1963, provides certain periods for filing suits, etc., in certain situations and if the party entitled to the remedy does not enforce its right within the prescribed time, then it is deprived of the remedy at law. In a way, this amounts to discharge of contract.

5.7 Discharge of Contracts by Breach

A breach of contract is one party's failure, without a legal excuse, to live up to any of its promises under a contract. A contract terminates by breach of contract. If the promisor has not performed his promise in accordance with the terms of the contract or where the performance is not excused by tender, mutual consent or impossibility or operation of law, then this amounts to a breach of contract on the part of the promisor. The consequence of this is that the promisee becomes entitled to certain remedies. The breach of contract may arise in two ways: (i) anticipatory and (ii) actual.

Anticipatory breach of contracts. The anticipatory breach of contract occurs when a party repudiates it before the time fixed for performance has arrived or when a party by his own act disables himself from performing the contract.

Example: A contracts to supply B with certain articles on 1st August. On 20th July, he informs B that he will not be able to supply the goods. B is entitled to sue A for breach of promise.

The anticipatory breach is also known as 'breach by repudiation'. Repudiation is a clear statement by one party before performance is due that it cannot or will not perform a material part of the contract obligation. Suppose that the day before your friend was to pick up the fiat that your promised to sell him, you sent your friend a message that you decided to sell the car to someone else. That would be repudiation or anticipatory breach. It also would be repudiation if your friend heard from another reliable source that you sold the car to someone else (There would be no reason to believe that you would get it back to sell the car to your friend tomorrow). However, it is not repudiation if one party will not perform because of an honest disagreement over the contract's terms.

Consequence of anticipatory breach. Where a party to a contract refuses to perform his part of the contract before the actual time arrives, the promisee may either (i) rescind the contract and treat the contract as at an end, and at once sue for damages, or (ii) he may elect not to rescind but to treat the contract operative and wait for the time of performance and then hold the other party liable for the consequences of non-performance. In the latter case, the party who has repudiated may still perform if he can.

The anticipatory breach of contract does not by itself discharges the contract. The contract is discharged only when the aggrieved party accepts the repudiation of the contract, i.e., elects to rescind the contract. Thus, if the repudiation is not accepted and subsequently an event happens discharging the contract legally, the aggrieved party shall lose his right to sue for damages. A agreed to load a cargo of wheat on B's ship by a particular date but when the ship arrived, A refused to load the cargo. B did not accept the refusal and continued to demand the cargo. Before the last date of loading had expired war broke out rendering the performance of the

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contract illegal. Held, the contract was discharged and B could not sue for damages [Avery v. Bowen (1856) 6 E & B 965].

Actual breach of contracts. The actual breach can occur by (i) failure to perform as promised, (ii) making it impossible for the other party to perform. The failure to perform means that one party must not have performed a material part of the contract by a stated deadline. The actual breach by failure to perform may take place (a) at the time when performance is due, or (b) during the performance of the contract. Thus, if a person does not perform his part of the contract at the stipulated time, he will be liable for its breach.

Example: A, the seller, offers to execute a deed of sale only on payment by the buyer of a sum higher than is payable under the contract for sale, he shall be liable for the breach.

But, if the promisor offers to perform his promise subsequently, the question arises whether it should be accepted, or whether the promisee can refuse such acceptance and hold the promisor liable for the breach. The answer depends upon whether time was considered by the parties to be of the essence of the contract. Section 55 provides the meaning of 'time to be the essence of a contract' and is discussed below.

Breach during the performance of the contract. The actual breach of contract also occurs when during the performance of the contract, one party fails or refuses to perform his obligation under the contract.

Example: A contracted with a Railway Company to supply it certain quantity of railway chairs at a certain price. The delivery was to be made in installments. After a few installments had been made, the Railway Company asked A to deliver no more. Held, A could sue for breach of contract.

How is a contract breached by making performance impossible? Suppose you hire an agency to clean carpets in your home on Saturday for ₹ 500. You go out for the day neglecting to make arrangements to let the agency people into your home to clean the carpets. You have breached the contract by making performance impossible. You would owe the money since the cleaning agency could not clean and because the agency probably turned down requests to clean for other clients.

Partial breach of a contract. That happens when a non-material (unimportant) part of the contract gets breached. It may happen if the contract has several divisible parts each of which you may treat as a separate contract. Then you could sue for damages even though the breach is not complete. An example of this would be agreeing to perform a duty once every three months for one year and then not performing for the final three months.

5.8 Time as the Essence of a Contract (S. 55)

We have seen above that if a person does not perform his part of the contract at the stipulated time, he will be liable for its breach. But if the promisor offers to perform his promise subsequently the question arises whether it should be accepted or whether the promisee can refuse such acceptance and hold the promisor liable for the breach. The answer depends upon whether time was considered by the parties to be of the essence of the contract or not. When a party to a contract promises to do a certain thing at or before a specified time, and fails to do any such thing at or before the specified time, the contract becomes voidable at the option of the promisee, if the intention of the parties was that time should be of the essence of the contract. If it was not the intention of the parties that time should be of the essence of the contract, the contract does not become voidable by failure to do such thing at or before the specified time but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure. However, if in case of a contract voidable on account of the promisor's failure to

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perform his promise at the agreed time, the promisee accepts performance of such promise at any time other than agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless at the time of such acceptance he gives notice to the promisor of his intention to do so. Thus, if the performance beyond the stipulated time is accepted, the promisee must give notice of his intention to claim compensation. If he fails to give such notice he will be deemed to have waived that right.

5.9 What is the Effect of the Death of one Party on the Contract?

The contract may or may not be discharged. It depends upon the personal skill, qualification or ability of the promisor. Where the personal skill, qualification or ability of the promisor is the basis of the contract the contract stands discharged by his death or physical disablement or illness as a result of which the contract could not be performed. However, in a case where the personal skill, qualification or ability of the promisor is not the basis of a contract, his death does not result in the discharge of his obligations under the contract.

Example:

(i) A agrees to paint a picture for B by a certain date. A dies before that time without painting the agreed picture. The death of A results in the discharge of the contract and therefore his legal representatives are not liable either to perform the contract or to pay compensation for non-performance.

(ii) A borrows a sum of ₹ 5,000 from B to be paid by a certain date. A dies before that date without meeting his obligation. His legal representatives are liable to pay the borrowed amount. However, their liability is limited to the extent of the value of the assets inherited.

5.10 Summary

- A contract creates obligations. 'Performance' of contract means the carrying out of obligations under it. The parties to contract must either perform or offer to perform their respective promises unless such performance is dispensed with or excused under the provisions of the Indian Contract Act, or some law (s.37).
- The promise may be performed by promisor himself or his agent or by his legal representative. (i) In case, there was an intention of the parties that the promise must be performed by the promisor himself, such promise is to be performed by him only. Thus, where A promises to paint a picture for B, then A must perform this promise personally. (ii) If there is no such intention of the parties, then the promisor may employ a competent person to perform the promise. If A has promised to deliver some items of grocery to B, A may perform this promise either personally delivering the items to B or causing it to be delivered to B through someone.
- In the case of mutual and dependent promises, the performance of one party depends upon the prior performance of the other party. If the promisor, who must perform, fails to perform it, he cannot claim the performance of the reciprocal promise. On the other hand, he must compensate the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.
- In the case of mutual and independent promises, each party must perform his promise without waiting for the performance or readiness to perform on the part of the other. A promises B to deliver him goods on 10 July and B in turn promises to pay the price on 6 July. B's paying the price is independent of A's delivering the goods and even if B does not pay the price on 6 July, A must offer the delivery of the goods on 10 July. A can, of course, sue B for price and damages.

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- In the case of mutual and concurrent promises, the performance is to be simultaneous. Thus, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.
- In India, the rules regarding appropriation of payments are contained in Ss. 59 to 61 which, in fact, have adopted with certain modifications the rules laid down in Clayton's case. The provisions of these sections are summarised hereunder:
- A contract may be discharged by (i) performance; (ii) tender; (iii) mutual consent; (iv) subsequent impossibility; (v) operation of law; (vi) breach.
- If the parties to a contract agree to substitute a new contract for it, or to rescind it or alter it, the original contract is discharged. A contract may terminate by mutual consent in any of the six ways viz. novation, rescission, alteration and remission, waiver and merger. Novation means substitution of a new contract for the original one. The new contract may be substituted either between the same parties or between different parties.
- A contract may be discharged because of impossibility of performance. There are two types of impossibility: (i) Impossibility may be inherent in the transaction (i.e., the contract), (ii) Impossibility may emerge later by the change of certain circumstances material to the contract.
- The anticipatory breach of contract occurs when a party repudiates it before the time fixed for performance has arrived or when a party by his own act disables himself from performing the contract.
- The anticipatory breach of contract does not by itself discharges the contract. The contract is discharged only when the aggrieved party accepts the repudiation of the contract, i.e., elects to rescind the contract. Thus, if the repudiation is not accepted and subsequently an event happens discharging the contract legally, the aggrieved party shall lose his right to sue for damages.

5.11 Keywords

Alteration: If the parties mutually are to change certain terms of the contract, it has the effect of terminating the original contract. There is, however, no change in the parties.

Appropriation of payments: Means application of payments.

Commercial impossibility: It means that if the contract is performed, it will result in a loss to the promisor.

Performance of joint promises: The Act provides rules for devolution of joint liabilities and rights.

Reciprocal promises: Means a promise in return for a promise.

Remission (s.63): It is the acceptance of a lesser sum than what was contracted for or a lesser fulfillment of the promise made.

Waiver: It means relinquishment or abandonment of a right.

5.12 Self Assessment

Fill in the blanks:

1. A contract creates obligations. ..... of contract means the carrying out of obligations under it.

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2. ..... requires that when two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfil the promise.
3. The ..... of joint promisors is joint as well as several.
4. ..... means a promise in return for a promise.
5. ..... provides that where persons reciprocally promise, firstly, to do certain things which are legal and secondly, under specified circumstances, to do certain things which are illegal, the first set of promises is a contract but the second set is a void agreement.
6. ..... means application of payments.
7. The obvious mode of ..... is by performances that is where the parties have done whatever was contemplated under the contract, the contract comes to an end.
8. The performance of the contract must be executed personally by the ....., his death or physical disability to perform shall render the contract void and thus exonerate him from the obligation.
9. ..... to perform a contract does not discharge the contract.
10. The ..... of contract occurs when a party repudiates it before the time fixed for performance has arrived or when a party by his own act disables himself from performing the contract.

5.13 Review Questions

1. (i) What is meant by performance of contracts? (ii) What is meant by offer to perform? (iii) Who must perform the promise under a contract? (iv) Are there any contracts which need not be performed?
2. Summarise the rules regarding the time, place and manner of performance of contracts.
3. What is a reciprocal promise. Into how many groups reciprocal promises may be divided? Summarise the rules concerning performance of different kinds of reciprocal promises.
4. Explain (i) Novation, (ii) assignment of contracts?
5. What are the different modes of discharge of contracts? Explain the discharge of contract by performance or tender.
6. (i) Explain the concept of "subsequent impossibility" as a mode of discharge of contract. (ii) "Impossibility of performance is, as a rule, not an excuse for non-performance of a contract". Discuss.
7. Discuss the consequences of non-performance of a valid contract.
8. When does a contract discharge by operation of law?

Answers: Self Assessment

1. 'Performance'
2. Section 42
3. liability
4. Reciprocal promises
5. Section 57
6. Appropriation of payments
7. discharge of a contract
8. promisor
9. Commercial impossibility
10. anticipatory breach

Notes

5.14 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S .S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

Unit 6: Remedies for Breach of Contract

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CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain remedies for branch of contract
- Discuss liquidated damages and penalty
- Describe freedom to contract

Introduction

In last unit you have studied about the performance contract and different modes discharge of contact. A contract may be discharged by performance, tender, mutual consent, subsequent impossibility, operation of law, and breach. As you come to know that a contract may terminate by mutual consent in any of the six ways viz. Novation, rescission, alteration and remission, waiver and merger. Novation means substitution of a new contract for the original one. This unit will provides you a significant understanding related to breach of contract. This unit will also provide an explanation of quasi-contracts.

6.1 Remedies for Breach of Contracts

When someone breaches a contract, the other party is no longer obligated to keep its end of the bargain. From there, that party may proceed in several ways: (i) the other party may urge the breaching party to reconsider the breach; (ii) if it is a contract with a merchant, the other party may get help from consumers' associations; (iii) the other party may bring the breaching party to an agency for alternative dispute resolution; (iv) the other party may sue for damages; or (v) the other party may sue for other remedies.

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As soon as either party commits a breach of the contract, the other party becomes entitled to certain reliefs. These remedies are available under the Indian Contract Act, 1872, as also under the Specific Relief Act, 1963. There are three remedies under the Specific Relief Act, 1963: (i) a decree for specific performance (s.10); (ii) an injunction (s.38-41); (iii) a suit on quantum meruit (s.30).

Remedies under the Indian Contract Act, 1872 are: (i) rescission of the contract (s.39) and, (ii) damages for the loss sustained or suffered.

Rescission of the contract. When a breach of contract is committed by one party, the other party may treat the contract as rescinded. In such a case the aggrieved party is freed from all his obligations under the contract. Thus, where A promises B to supply one bag of rice on a certain date and B promises to pay the price on receipt of the bag. A does not deliver the bag of rice on the appointed day, B need not pay the price. A person who rightfully rescinds the contract is entitled to compensation for any damage which he has sustained through the non-fulfillment of the contract.

Damages (s.75). Another relief or remedy available to the promisee in the event of a breach of promise by the promisor is to claim damages or loss arising to him therefrom. Damages under s.75 are awarded according to certain rules as laid down in Ss. 73-74. Section 73 contains three important rules: (i) Compensation as general damages will be awarded only for those losses that directly and naturally result from the breach of the contract. (ii) Compensation for losses indirectly caused by breach may be paid as special damages if the party in breach had knowledge that such losses would also follow from such act of breach. (iii) The aggrieved party is required to take reasonable steps to keep his losses to the minimum. It is the duty of the injured party to minimise loss. (*British Westinghouse & Co. v Underground Electric etc. Co.* (1915) A.C.673). He cannot claim to be compensated by the party in default for loss which is really not due to the breach but due to his own neglect to minimise loss after the breach.

Thus, the loss or damages caused to the aggrieved party must be such that either (i) it arose naturally or (ii) the parties knew, when they made the contract, was likely to arise. In other words, such compensation cannot be claimed for any remote or indirect loss or damage sustained by reason of the breach of the contract.

Section 74 provides that if the parties agree in their contract that whoever commits a breach shall pay an agreed amount as compensation, the court has the power to award a reasonable amount only, subject to such agreed amount.

Different types of damages. There are four types of damages

Ordinary. These damages are those which naturally arise in the usual course of things from such breach. The measure of ordinary damages is the difference between the contract price and the market price at the date of the breach. If the seller retain the goods after the breach, he cannot recover from the buyer any further loss if the market falls, nor is he liable to have the damages reduced if the market rises.

Example:

(i) A contracts to deliver 10 bags of rice at ₹ 500 a bag on a future date. On the due date he refuses to deliver. The price on that day is ₹ 520 per bag. The measure of damages is the difference between the market price on the date of the breach and the contract price, i.e., ₹ 200.

(ii) A contracts to buy B's ship for ₹ 2,00,000 but breaks his promise. A must pay to B by way of compensation the excess, if any, of the contract price over the price which B can obtain for the ship at the time of the breach of promise.

The ordinary damages cannot be claimed for any remote or indirect loss or damages by reason of the breach. The ordinary damages shall be available for any loss which arises naturally in

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the usual course of things. A railway passenger's wife caught cold and fell ill due to her being asked to get down at a place other than the railway station. In a suit by the plaintiff against the railway company, held that damages for the personal inconvenience of the plaintiff alone could be granted, but not for the sickness of the plaintiff's wife, because it was a very remote consequence.

What is the most common remedy for breach of contracts? The usual remedy for breach of contracts is suit for damages. The main kind of damages awarded in a contract suit are ordinary damages. This is the amount of money it would take to put the aggrieved party in as good a position as if there had not been a breach of contract. The idea is to compensate the aggrieved party for the loss he has suffered as a result of the breach of the contract.

Special damages. These damages are claimed in case of loss of profit, etc. When there are certain special or extraordinary circumstances present and their existence is communicated to the promisor, the non-performance of the promise entitles the promisor to not only the ordinary damages but also damages that may result therefrom. The communication of the special circumstances is a prerequisite to the claim for special damages.

Example:

(i) A, a builder, contracts to erect and finish a house by the first of January, in order that B may give possession of it at that time to C, to whom B has contracted to let it. A is informed of the contract between B and C. A builds the house so badly that before the 1st of January it falls down and had to be rebuilt by B, who in consequence loses the rent which he was to have received from C, and is obliged to make compensation to C for the breach of his contract. A must make compensation to B for the cost of rebuilding the house, for the rent lost and for the compensation made to C.

(ii) A delivers to B, a common carrier, a machine to be conveyed without delay to A's mill, informing B that his mill is stopped for want of the machine. B unreasonably delays the delivery of the machine and A, in consequence, loses a profitable contract with the government. A is entitled to receive from B, by way of compensation, the average amount of profit which would have been made by the working of the mill during the time that delivery of it was delayed. But, however, the loss sustained through the loss of the government contract cannot be claimed.

(iii) X's mill was stopped due to the breakdown of a shaft. He delivered the shaft to Y, a common carrier, to be taken to a manufacturer to copy it and make a new one. X did not make known to Y that delay would result in a loss of profits. By some neglect on the part of Y the delivery of the shaft was delayed in transit beyond a reasonable time. As a result, the mill remained idle for a longer time than otherwise would have been, had the shaft been delivered in time. Held, Y was not liable for loss of profits during the period of delay as the circumstances communicated to Y did not show that a delay in the delivery of the shaft would entail loss of profits to the mill. [*Hadley v. Baxendale*].

(iv) Where A contracts to sell and deliver to B on the 1st of January certain cloth which B intends to manufacture into caps of a particular kind for which there is no demand except in that season. The cloth is not delivered till after the appointed time and too late to be used that year in making caps. B is entitled to receive from A only ordinary damages, i.e., the difference between the contract price of the cloth and its market price at the time of delivery but not the profits which he expected to obtain by making caps, nor the expenses which he has incurred in making preparation for the manufacture of caps.

Task

Give examples related to Breach of Contract.

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6.2 Liquidated Damages and Penalty

Sometimes parties themselves at the time of entering into a contract agree that a particular sum will be payable by a party in case of breach of the contract by him. Such a sum may either be by way of 'liquidated damages' or it may be way of 'penalty'. The essence of liquidated damages is a genuine covenanted pre-estimate of the damages. Thus, the stipulated sum payable in case of breach is to be regarded as liquidated damages if it be found that parties to the contract conscientiously tried to make a pre-estimate of the loss which might happen to them in case the contract was broken by any of them. On the other hand, the essence of a penalty is a payment of money stipulated as "in terrorem" of the offending party. Thus, if it is found that the parties made no attempt to estimate the loss that might happen to them on breach of the contract but still stipulated a sum to be paid in case of a breach of it, with the object of coercing the offending party to perform the contract it is a case of penalty.

It is obvious that a term in a contract amounts to a penalty where a sum of money, which is out of all proportion to the loss, is stipulated as payable in case of its breach. Where the amount payable, in case of its breach, is fixed in advance whether by way of liquidated damages or penalty, the party may claim only a reasonable compensation for the breach, not exceeding the amount so named or, as the case may be, the penalty stipulated for. (s.74).

Example:

(i) A contracts with B to pay B ₹ 1,000 if he fails to pay B ₹ 500 on that day. A fails to pay ₹ 500 on that day. B is entitled to recover from A such compensation not exceeding ₹ 1,000, as the court considers reasonable.

(ii) A contracts with B that if A practices as a surgeon within Calcutta, he will pay B ₹ 5,000. A practices as a surgeon in Calcutta. B is entitled to such compensation not exceeding ₹ 5,000 as the court considers reasonable.

Whether payment of interest at a higher rate amounts to penalty? Whether an agreement to pay interest at a higher rate in the case of breach of a contract amounts to penalty shall depend upon the circumstances of each case. However, following rules may be helpful in understanding the legal position in this regard.

(i) A stipulation for increased interest from the date of default shall be a stipulation by way of penalty if the rate of interest is abnormally high. A gives B a bond for the repayment of ₹ 1,000 with interest at 12% p.a. at the end of six months with a stipulation that in case of default interest shall be payable at the rate of 75 percent from the date of default. This is a stipulation by way of penalty and B is only entitled to recover from A such compensation as the court considers reasonable.

(ii) Where there is a stipulation to pay increased interest from the date of the bond and not merely from the date of default; it is always to be considered as penalty.

(iii) As regards compound interest, it is not itself a penalty. But it is allowed only in cases where the parties expressly agree to it. However, a stipulation to pay compound interest at a higher rate on default is considered as a penalty.

(iv) An agreement to pay a particular rate of interest with stipulation that a reduced rate will be acceptable if paid punctually is not a stipulation by way of penalty. Thus, where a bond provided for payment of interest at 12% p.a. with a provision that if the debtor pays interest punctually at the end of every year the creditor would accept interest at the rate of 9% p.a. Such a clause is not in the nature of penalty and hence interest @ 12% shall be payable.

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Vindictive or punitive damages. These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff. These have been awarded (a) for breach of a promise to marry; (b) for wrongful dishonour of a cheque by a banker possessing adequate funds of the customer. The measure of damages in case (a) is dependent upon the severity of the shock to the sentiments of the promisee. In case (b), the rule is smaller the amount of the cheque dishonoured larger will be the amount of damages awarded.

Nominal damages. These are awarded in cases of breach of contract where there is only technical violation of the legal right but no substantial loss is caused thereby. The damages granted in such cases are called nominal because they are very small, for example, a rupee. This small amount is awarded as a matter of course.

Task

Discuss an example related to liquidated damages and Penalty.

6.2.1 Meaning of Specific Performance

There are other remedies in a contract suit besides damages. The main one is specific performance. Where damages are not an adequate remedy, the court may direct the party in breach to carry out his promise according to the term of the contract. This is called specific performance of the contract. Some of the instance where court may direct specific performance are: a contract for the sale of particular house or some rare article (antique) or any other thing for which monetary compensation is not enough because the injured party will not be able to get an exact substitute in the market. However, specific performance may not be granted where (i) monetary compensation is an adequate relief; (ii) the contract is of personal nature, e.g., a contract to paint a picture; (iii) where it is not possible for the court to supervise the performance of the contract, e.g., a building contract; (iv) the contract is made by an incorporated company beyond its object clause as laid down in its memorandum of association.

6.2.2 Remedy of Injunction

Injunction means an order of the court prohibiting a person to do something where a party is in breach of a negative term of contract (i.e., where he does something which he promised not to do), the court may by, issuing an order, prohibit him from doing so. Thus where N, a film star, agreed to act exclusively for a particular producer for one year but she contracted to act for some other producer, she could be restrained by an injunction to do so.

6.2.3 Remedy by way of a Suit on Quantum Meruit

The phrase 'quantum meruit' means as much as is merited (earned). The normal rule of law is that unless a party has performed his promise in its entirety, it cannot claim performance from the other. To this rule, however, there are certain exceptions on the basis of 'quantum meruit'. A right to sue on a 'quantum meruit' arises where a contract partly performed by one party has become discharged by the breach of other party.

6.3 Freedom to Contract

The Parties to a Contract, in a Sense, Make the Law for Themselves

The law of contract differs from other branches of law in a very important aspect. It does not lay down so many precise rights and duties which the law will protect and enforce; it contains rather a number of limiting principles subject to which the parties may create rights and duties

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for themselves and the law will uphold those rights and duties. So long as the parties to a contract do not transgress some legal provision, they can agree for any terms they like in regard to the subject matter of their contract and the law will give effect to their contract. Let us illustrate. A agrees to sell his motorcycle worth ₹ 15,000 for ₹ 6,000 only to B. The agreement gives rise to a legal obligation on the part of A to deliver the motorcycle to B and on the part of B to pay ₹ 6,000 to A. They may fix any terms as regards time of delivery and that of payment. The payment may be agreed to be made by installments. Though the motorcycle is worth ₹ 15,000, it is being sold for ₹ 6,000 only. Assuming all the essential elements of a valid contract are present, the contract is enforceable by law. But many developments in the recent past have affected this freedom to contract.

Freedom to Contract is a Myth or an Illusion

The freedom of the parties is limited by two factors. There are certain laws for the protection of the employees, and an employer cannot, therefore, induce his employees to enter into any contract favourable to the employer. Further, the standard form of contract (with printed terms and conditions) is in vogue today, and several contracts entered into by laymen are not the result of individual negotiations. Thus, if a person is in need of electricity, or telephone connection, it is not possible for him to settle the terms of the agreement with the Electricity Board or the Telephone Corporation, etc. Each of them have their own printed contracts and the intending customer has either to accept on those terms, or go without electricity or telephone, as the case many be. In such a case, since one does not want to go without such necessary services, the individual is in effect compelled to accept all those standard terms. Thus, absolute freedom of contract is largely an illusion or mostly a myth.

The freedom to contract has been intervened in three ways, thereby making it a myth. These are: (i) enactment of laws by the welfare states to protect the interests of those parties to the contract which have a weak bargaining power, (ii) intervention by the courts, which refuse to enforce, and even rewrite terms in private contracts in order to protect the real or presumed victims of one sided or unfair or unconscionable contracts, (iii) widespread adoption of 'form contracting' by business.

Additional terms implied into the contract. In general, the contents of a contract are determined by agreement between the parties. Nevertheless, there are various circumstances in which additional terms may be supplied into the agreement. These additional terms may be implied by (i) custom (ii) courts (iii) statute. (i) A contract must always be examined in the light of its surrounding commercial context. The terms of a contract may have been negotiated against the background of the custom of a particular locality or trade. The parties automatically assume that their contract will be subject to such customs and so do not deal specifically with the matter in the contract. (ii) The courts will be prepared to imply a term into a contract in order to give effect to the obvious intention of the parties. Sometimes the point at issue has been overlooked or the parties have failed to express their intention clearly. In these circumstances, the court will supply terms in the interests of 'business efficacy' so that the contract makes commercial common sense. Certain standard terms have been implied by the common law in a number of business contracts. The courts will imply a term into a lease of furnished house that it will be reasonably fit for habitation at the start of the tenancy. A contract of employment is subject to a number of implied terms. An employer is under a legal duty to provide a safe system of work for his employees, while an employee is under a duty to obey legitimate orders and show good faith towards his employer. By implying a term into the contract, the court is imposing reasonable obligations which the parties would have no doubt included in their agreement, if they had troubled to think about the matter. These implied terms may be excluded by express agreement between the parties. (iii) By statute. A term may be implied in a contract by an Act of Parliament. In many cases, these implied terms which began life among the customs of merchants, were recognized

by the courts and then included in the statute by codification. The best example of this process is provided by law relating to the sale of goods.

Notes

6.4 Summary

- As soon as either party commits a breach of the contract, the other party becomes entitled to certain reliefs. These remedies are available under the Indian Contract Act, 1872, as also under the Specific Relief Act, 1963. There are three remedies under the Specific Relief Act, 1963: (i) a decree for specific performance (s.10); (ii) an injunction (s.38-41); (iii) a suit on quantum meruit (s.30).
- Thus, the loss or damages caused to the aggrieved party must be such that either (i) it arose naturally or (ii) the parties knew, when they made the contract, was likely to arise. In other words, such compensation cannot be claimed for any remote or indirect loss or damage sustained by reason of the breach of the contract.
- What is the most common remedy for breach of contracts. The usual remedy for breach of contracts is suit for damages. The main kind of damages awarded in a contract suit are ordinary damages. This is the amount of money it would take to put the aggrieved party in as good a position as if there had not been a breach of contract. The idea is to compensate the aggrieved party for the loss he has suffered as a result of the breach of the contract.
- There are other remedies in a contract suit besides damages. The main one is specific performance. Where damages are not an adequate remedy, the court may direct the party in breach to carry out his promise according to the term of the contract. This is called specific performance of the contract.
- The freedom to contract has been intervened in three ways, thereby making it a myth. These are: (i) enactment of laws by the welfare states to protect the interests of those parties to the contract which have a weak bargaining power, (ii) intervention by the courts, which refuse to enforce, and even rewrite terms in private contracts in order to protect the real or presumed victims of one sided or unfair or unconscionable contracts, (iii) widespread adoption of 'form contracting' by business.

6.5 Keywords

Nominal damages: These are awarded in cases of breach of contract where there is only technical violation of the legal right but no substantial loss is caused thereby.

Ordinary damages: Cannot be claimed for any remote or indirect loss or damages by reason of the breach.

Special damages: These damages are claimed in case of loss of profit.

Vindictive or punitive damages: These damages are awarded with a view to punish the defendant and not solely with the idea of awarding compensation to the plaintiff.

6.6 Self Assessment

Fill in the blanks:

1. When a ..... is committed by one party, the other party may treat the contract as rescinded.
2. ..... as general damages will be awarded only for those losses that directly and naturally result from the breach of the contract.

Notes

3. ..... provides that if the parties agree in their contract that whoever commits a breach shall pay an agreed amount as compensation, the court has the power to award a reasonable amount only, subject to such agreed amount.
4. The ..... of the special circumstances is a prerequisite to the claim for special damages.
5. ..... means an order of the court prohibiting a person to do something where a party is in breach of a negative term of contract (i.e., where he does something which he promised not to do), the court may by, issuing an order, prohibit him from doing so.
6. The phrase ..... means as much as is merited (earned).
7. The ..... differs from other branches of law in a very important aspect.
8. The freedom of the parties is limited by ..... .
9. The ..... cannot be claimed for any remote or indirect loss or damages by reason of the breach.

6.7 Review Questions

1. What are the different ways in which a breach of contract may arise?
2. Whether time is the essence of a contract or not?
3. What are the main types of remedies for breach of a contract?
4. State the principles on which damages are awarded for breach of contracts.
5. Give some examples of ordinary damages. Can ordinary damages be claimed for any remote or indirect loss or damage by reason of the breach?
6. Give some examples of special damages. Is it that the communication of the special circumstances a prerequisite to the claim for special damages?
7. What is meant by liquidated damages and penalty?
8. What is specific performance? Under what circumstances, it is (i) granted (ii) not granted?
9. What is a penalty clause? Why is it that the court will not enforce a penalty clause?
10. Explain (i) exemplary damages (ii) quantum meruit.

Answers: Self Assessment

1. breach of contract
2. Compensation
3. Section 74
4. communication
5. Injunction
6. 'quantum meruit'
7. law of contract
8. two factors
9. ordinary damages

6.8 Further Readings

Notes

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S .S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://lawcommissionofindia.nic.in/1-50/Report13.pdf

http://business.gov.in/manage_business/contract_law.php

Notes

Unit 7: Contracts of Guarantee and Indemnity

CONTENTS

Objectives

Notes

After studying this unit, you will be able to:

- Discuss meaning and purpose of the contracts of indemnity and guarantee
- Explain essential features of both the indemnity and guarantee
- Describe different kinds of guarantee
- State difference between indemnity and guarantee

Introduction

In last unit, you studied about Contract Act and breach and anticipatory breach of contract. When a company needs some money for its business it approaches a bank. The bank requires that the managing director *M* promises to repay the loan personally should the company default. When the directors of the company including *M* execute the promissory note on behalf of the company, they sign as company's officials. *M*, the managing director signs again as an individual. The relationship between *M* and the bank is called a guarantee or surety ship. It is a contractual relationship resulting from the unconditional promise of *M* (known as the surety or guarantor) to repay the loan to the creditor (the bank) for the obligation of the principal debtor (the company) should it default. If the company fails to repay the loan, the bank can approach *M* for the payment. The law relating to the contracts of guarantee is given in the Indian Contract Act, 1872 (Ss.126-147). The sections quoted in this unit refer to the contract of guarantee and contract of indemnity.

7.1 Purpose and Meaning of the Contracts of Guarantee

In this unit our primary concern is with the contracts of guarantee which are used for securing loan.

7.1.1 Purpose of Guarantee

The contracts of guarantee are among the most common business contracts and are used for a number of purposes. These are:

1. The guarantee is generally made use of to secure loans. Thus, a contract of guarantee is for the security of the creditor.
2. The contracts of guarantee are sometimes called performance bonds.

Example: In the case of a construction project, the builder may have to find a surety to stand behind his promise to perform the construction contract.

Also employers often demand a type of performance bond known as a fidelity bond from employees who handle cash, etc., for the good conduct of the latter. If an employee misappropriates then the surety will have to reimburse the employer.

3. Bail bonds, used in criminal law, are a form of contract of guarantee. A bail bond is a device which ensures, that a criminal defendant will appear for trial. In this way a prisoner is released on bail pending his trial. If the prisoner does not appear in the court as desired then the bond is forfeited.

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7.1.2 Definition and Nature of the Contract of Guarantee (S.126)

A contract of guarantee is defined as "a contract to perform the promise, or discharge the liability, of a third person in case of his default". The person who gives the guarantee is called 'surety'; the person for whom the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given is called the 'creditor'. A contract of guarantee may be either oral or in writing.

From the above discussion, it is clear that in a contract of guarantee there must, in effect, be two contracts, a principal contract between the principal debtor and creditor, and a secondary contract between the creditor and the surety. In a contract of guarantee there are three parties, viz., the creditor, the principal debtor and the surety. Therefore, there is an implied contract also between the principal debtor and the surety.

Example: When A requests B to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C failing to do so, he will himself pay to B, there is a contract of guarantee.

The contract of surety is not contract collateral to the contract of the principal debtor, but is an independent contract. There must be a distinct promise on the party of the surety to be assumable for the debt. It is not necessary that the principal contract, between the debtor and the creditor, must exist at the time the contract of guarantee is made; the original contract between the debtor and creditor may be about to come into existence. Similarly, under certain circumstances, a surety may be called upon to pay though principal debtor is not liable at all.

Also, where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join (s.144).

7.1.3 Fiduciary Relationship

A contract of guarantee is not a contract "*uberrimae fidei*" (requiring utmost good faith). Nevertheless, the surety ship relation is one of trust and confidence and the validity of the contract depends upon good faith on the part of the creditor. A creditor must disclose all those facts which, under the circumstances, the surety would expect not to exist. So where guarantee is given for good conduct of an employee, the employer's failure to inform the surety of any breach on the part of employee, will discharge the surety. Similarly, where *X* guarantees the existing and future liabilities of *A* to *B* up to a certain amount which limit has already been exceeded, the contract of guarantee can be avoided on the ground of concealment of a materiel fact. However, it should be noted that it is no part of the creditor's duty to inform the surety about all his previous dealings with the debtor.

7.2 Kinds of Guarantee

There are various kinds of guarantee such as oral, written, specific, continuing and whole debt or a part of debt.

7.2.1 Oral or Written Guarantee

A contract of guarantee may either be oral or in writing (s.126), though a creditor should always prefer to put it in writing to avoid any dispute regarding the terms, etc. In case of an oral agreement, the existence of the agreement itself is very difficult to prove.

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7.2.2 Specific and Continuing Guarantee

From the point of view of the scope of guarantee a contract of guarantee may either by specific or continuing. A guarantee is a "specific guarantee", if it is intended to be applicable to a particular debt and thus comes to end on its repayment. A specific guarantee once given is irrevocable.

Example: A guarantees the repayment of a loan of ₹ 10,000 to B by C (a banker). The guarantee in this case is a specific guarantee.

A guarantee which extends to a series of transactions is called a "continuing guarantee" (s.129)

Example: A guarantees payment to B, a tea-dealer, to the amount of ₹ 10,000 for any tea he may from time to time supply to C. B supplies C with tea of the value above ₹ 10,000 and C pays B for it. Afterwards B supplies C with tea to the value of ₹ 15,000. C fails to pay. The guarantee given by A was a continuing guarantee and he is accordingly liable to B to the extent of ₹ 10,000.

A guarantee regarding the conduct of another person is a continuing guarantee. Unlike a specific guarantee which is irrevocable, a continuing guarantee can be revoked regarding further transactions (s.130). However, continuing guarantee cannot be revoked regarding transactions that have ready taken place.

Examples: (i) X guarantees repayment of advances made to A within 6 months subject to a maximum of ₹ 20,000. If ₹10,000 has been advanced by the end of 2 months, guarantee is irrevocable insofar as this advance of ₹ 10,000 is concerned.

(ii) A guarantees to B to the extent of ₹ 10,000 that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (s.131).

7.2.3 A Guarantee may either be for the Whole Debt or a Part of the Debt

Difficult questions arise in case of guarantee for a limited amount because there is an important distinction between a guarantee for only a part of the whole debt and a guarantee for the whole debt subject to a limit. For instance, where X owes Y ₹ 50,000 and A has stood as surety for ₹ 30,000, the question may arise whether A has guaranteed ₹ 30,000 out of ₹ 50,000 or whether he has guaranteed the full amount of ₹ 50,000 subject to a limit of ₹ 30,000. This matter becomes important if X is adjudged insolvent and Y wants to prove in X's insolvency and also enforce his remedy against A. If A stood surety only for a part of the debt and if X's estate can pay only 25 paisa dividend in the rupee, then Y can get ₹ 30,000 the full amount of guarantee from A and ₹ 5,000 from X's estate, being ¼ of the balance, i.e., ₹ 50,000 – ₹ 30,000 = ₹ 20,000 which was not guaranteed. Since after paying ₹ 30,000 to Y, A can claim from X's estate, he will get ₹ 7,500 being ¼ of ₹ 30,000 paid by A to Y. If on the other hand, A had stood surety for the whole debt of ₹ 50,000 subject to a limit of ₹ 30,000 then Y can recover from A ₹ 30,000 and from X's estate ₹ 12,500, i.e., ¼ of ₹ 50,000. A will not get any dividend unless Y has been fully paid. This can happen only if X's estate declares a higher dividend.

Notes

7.3 Right and Obligations of Creditors

7.3.1 Rights of a Creditor

Rights of creditors are as follows:

1. The creditor is entitled to demand payment from the surety as soon as the principal debtor refuses to pay or makes default in payment. The liability of the surety cannot be postponed till all other remedies against the principal debtor have been exhausted. In other words, the creditor cannot be asked to exhaust all other remedies against principal debtor before proceeding against surety. The creditor also has a right of general lien on the securities of the surety in his possession. This right, however, arises only when the principal debtor has made default and not before that.
2. Where surety is insolvent, the creditor is entitled to proceed in the surety's insolvency and claim the pro rata dividend.

7.3.2 Obligations Imposed on a Creditor in a Contract of Guarantee

Obligations imposed on a creditor in a contract of guarantee are as follow:

1. ***Not to change any terms of the original contract:*** The creditor should not change any terms of the original contract without seeking the consent of the surety. Section 133 provides. "any variance made, without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to the transactions subsequent to the variance".

Example: A banker contracts to lend X ₹ 5,000 on March 4. A guarantees repayment. The banker pays X ₹ 5,000 on January 1. A in this case is discharged from his liability as the contract has been varied as much as the banker might sue X before March 4, but it cannot sue A as the guarantee is from March 4.

2. ***Not to release or discharge the principal debtor:*** The creditor is under an obligation not to release or discharge the principal debtor. Section 134 states: "The surety is discharged by a contract between the creditor and principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor".

Example: A gives a guarantee to banker C for repayment of the debt granted to B. B later contracts with his creditors (including C, the banker) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C and A is discharged from his surety ship.

3. ***Not to compound, or give time to, or agree not to sue the principal debtor:*** Section 135 provides, "A contract between the creditor and the principal debtor, by which the creditor makes a composition with or promises to give time to, or not to use the principal debtor, discharges the surety, unless the surety assents to such contract".

   If the time for repayment is extended, the debtor may die or become insane or insolvent or his financial position may become weaker in the meanwhile, with one effect that the surety's remedy to recover the money in case the principal debtor defaults, may be impaired. However, there are certain exceptions. These are:

   (a) Section 136 states that if the creditor makes an agreement with a third party, but not with the principal debtor, to give extension of time to the principal debtor, surety is not discharged even if his consent has not been sought.

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Example: C the holder of an overdue bill of exchange, drawn by A as surety for B and accepted by B, contracts with M to give time to B. A is not discharged.

(b) Mere forbearance on the part of creditor to sue the principal debtor, or to enforce any other remedy against him, does not, in the absence of a provision to the contrary, discharge the surety (s.137).

Example: B owes C (a banker) a debt guaranteed by A and the debt becomes payable, but C does not sue B for a year after debt becomes payable. A is not discharged from his surety ship.

(c) If the creditor releases one of the co-sureties, the other co-surety (or co-sureties) thereby is not discharged. The co-surety released by the creditor is also not released from his liability to the other sureties (s.138).

4. ***Not to do any act inconsistent with the rights of the surety. (s.139):*** Where *C* lends money to *B* on the security of a joint and several promissory note made in *C*'s favour by *B* and by *A* as surety for *B*, together with a bill of sale of *B*'s furniture, which give power to *C* to sell the furniture and apply the proceeds in discharge of the note. Subsequently, *C* sells the furniture, but owing to his misconduct and wilful negligence, only a small price is realized, then A is discharged from liability on the note.

7.4 Rights, Liability and Discharge of Surety

Rights of a surety may be classified under three heads: (i) rights against the creditor, (ii) rights against the principal debtor and (iii) Rights against co-sureties.

7.4.1 Rights against the Creditor

In case of fidelity guarantee, the surety can direct creditor to dismiss the employee whose honesty he has guaranteed, in the event of proved dishonesty of the employee. The creditor's failure to do so will exonerate the surety from his liability.

7.4.2 Rights against the Principal Debtor

1. ***Right of subrogation:*** Section 140 lays down that where a surety has paid the guaranteed debt on its becoming due or has performed the guaranteed duty on the default of the principal debtor, he is invested with all the rights which the creditor has against the debtor. In other words, the surety is subrogated to all the rights which the creditor had against the principal debtor. So, if the creditor loses, or without the consent of the surety parts with any securities (whether known to the surety or not) the surety is discharged to the extent of the value of such securities (s.141). Further, the creditor must hand over to the surety, the securities in the same condition as they formerly stood in his hands.

2. ***Right to be indemnified:*** The surety has a right to recover from the principal debtor the amounts which he has rightfully paid under the contract of guarantee.

Task "A" advances to "B", a minor, Rs 500 on the guarantee of C. On demand for repayment B pleads minority. Can A recover that amount from C?

[***Hint:*** No. The liability of surety is extensive with that of the principal debtor.]

Notes

7.4.3 Rights against Co-sureties

Where a debt has been guaranteed by more than one person, they are called co-sureties. S.146 provides for a right of contribution between them. When a surety has paid more than his share or a decree has been passed against him for more than his share, he has a right of contribution from the other sureties who are equally bound to pay with him.

Example: A, B and C are sureties to D for the sum of ₹ 3,000 lent to E. E defaults in making payment. A, B and C are liable, as between themselves to pay ₹ 1,000 each and if any one of them has to pay more than his share, i.e., ₹ 1,000 he can claim contribution from the others, for the amount paid in excess of ₹ 1,000.

If one of the sureties becomes insolvent, the solvent co-sureties shall have to contribute the whole amount equally.

Where, the co-sureties have guaranteed different sums, they are bound under s. 147 to contribute equally, subject to the limit fixed by their guarantee and not proportionately to the liability undertaken.

Examples: (i) A, B and C as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of ₹ 10,000, B in that of ₹ 20,000, C in that of ₹ 40,000, conditioned for D's duly accounting to E. E makes default to the extent of ₹ 30,000. A, B and C are each liable to pay ₹ 10,000.

(ii) In the above example, if D makes default to the extent of ₹ 40,000, A is liable to pay ₹ 20,000 and B and C ₹ 15,000 each.

7.4.4 Liability of Surety

Unless the contract provides otherwise, the liability of the surety is co-extensive with that of the principal debtor (s. 128). In other words, the surety is liable for all those amounts the principal debtor is liable for.

Example: A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonored by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

The liability of a surety is called as secondary or contingent, as his liability arises only on default by the principal debtor. But as soon as the principal debtor defaults, the liability of the surety begins and runs co-extensive with the liability of the principal debtor, in the sense that the surety will be liable for all those sums for which the principal debtor is liable. The creditor may file a suit against the surety without suing the principal debtor. Further, where the creditor holds securities from the principal debtor for his debt, the creditor need not first exhaust his remedies against the securities before suing the surety, unless the contract specifically so provides.

The creditor is even not bound to give notice of the default to the surety, unless it is expressly provided for.

Position of Surety in case of a Minor Principal Debtor

According to the decision of the Bombay High Court in *Kashiba v. Shripat* I.L.R. 10 Bom. 1927 the surety can be held liable, though a minor debtor is not liable. But the later decisions of the Bombay High Court have taken a contrary view. In *Manju Mahadeo v. Shivappa Manju* and in *Pestonji Mody v. Meherbai* it was held that as under s.128, the liability of the surety is co-extensive

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with that of the principal debtor, it can be no more than that of the principal debtor and that the surety therefore cannot be held liable on a guarantee given for default by a minor. If a minor could not default, the liability of the guarantor being secondary liability, does not arise at all. The same view has been endorsed by the Madras High Court in the case of *Edavan Nambiar v. Moolaki Raman* (A.I.R. 1957 Mad. 164). It was held that unless the contract otherwise provides, a guarantor for a minor cannot be held liable.

7.4.5 Discharge of Surety

The liability of surety under a contract of a guarantee comes to an end under any one of the following circumstances:

1. ***By notice of revocation (s.130):*** A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

Example: A, in consideration of B's discounting, at A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of ₹ 5,000. B discounts bill for C to the extent of ₹ 2,000. Afterwards, at the end of the three months, A revokes the guarantee. The revocation discharges A from liability to B for any subsequent discount. But A is liable to B for ₹ 2,000 on default of C.

2. ***By the death of surety (s.131):*** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.

3. ***By variance in terms of the contract (s.133):*** Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

Example: A becomes surety to C for B's conduct as a manager in C's bank. Afterwards B and C contract, without A's consent, that B's salary shall be raised and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw and the bank loses a sum of money. A is discharged from his surety ship by the variance made without his consent and is not liable to make good this loss.

4. ***By release or discharge of principal debtor (s.134):*** The surety is discharged by any contract between the creditor and principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Examples:

(i) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here A is released from his debt by the contract with C and A discharged from his surety ship.

(ii) A contracts with B for fixed price to build a house for A within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his surety ship.

5. ***By compounding with, or giving time to, or agreeing not to sue, principal debtor (s.135):*** A contract between the creditor and the principal debtor by which the creditor makes a composition with, or promises to give time to, or not to sue the principal debtor, discharges the surety. The surety shall, however, be not discharged if (a) he assents to such contract, (b) the contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor.

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Example: C, the holder of an overdue bill of exchange drawn by A as surety for B and accepted by B, contracts with M to give time to B. A is not discharged.

6. ***By creditor's act or omission impairing surety's eventual remedy (s.139):*** If the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do and the eventual remedy of surety himself against the principal debtor is thereby impaired, the surety is discharged.

Examples:

(i) B contracts to build a ship for C for a given sum to be paid by instalments as the work reaches certain stages. A becomes surety of B's due performance of the contract. C, without the knowledge of A, repays to B the last two instalments. A is discharged by this prepayment.

(ii) A puts M as an apprentice to B and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see M make up the cash. B omits to see this done as promised and M embezzles. A is not liable to B on his guarantee.

7. ***Loss of security:*** If the creditor loses or parts with any security given to him by the principal debtor at the time the contract of guarantee was made, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security (s.141).

Example: C advances to B, his tenant ₹ 2,000 on the guarantee of A. C has also a further security for the ₹ 2,000 by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent and C sues A on his guarantee. A is discharged from liability to the amount of value of the furniture.

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Format of a Surety Bond

The deed is executed on the ….. day of …… 2003 ……. between S/o Shri ……. R/o …….. (hereinafter called the Employee of the first part and …… S/o Shri ……. R/o …….. New Delhi (hereinafter called the Surety) of the second part and The East India Hotels Ltd., 4 Mangoe Lane, Kolkata 700 001 (hereinafter called the Management) of the third part.

Whereas the Employee has applied to the Management for an advance of ₹ ……../- (Rupees ……../- only) for the construction of a house.

And whereas the Surety has agreed to give security for the repayment of such loan in the manner hereinafter in equal monthly instalments.

Now This Deed Witness As Follows.

1. In pursuance of the said agreement and in consideration of a sum of ₹ …/- (Rupees only) advanced by the Management to the Employee (receipt of which is hereby acknowledged), the Employee and the Surety hereby jointly and severally convenant with the management as under.
2. The Employees shall pay the Management the sum of ₹ ……/- (Rupees only) in equal monthly instalments of ₹ …… (Rupees …… only) with interest.
3. If there is any default on the part of the Employee to pay the monthly instalment for any reason, whatsoever, the Surety will pay the arrears for that particular month to the management.

Contd....

Notes

4. If the installments shall be in arrears for more than three months or in the event of the termination of the service of the employee for any reason, whatsoever, the whole sum remaining to the Management under this Deed on account of principal and interest shall thereon become payable at once and the employee and the Surety will be liable jointly and severally to pay the same and the Management shall be at liberty to recover the entire sum under this Deed in any manner they deem proper from the Employee and the Surety jointly and severally.

In Witness Thereof the Parties have Signed this Deed on the Day Mentioned Earlier

First Party Witness

Second Party 1.

Third Party 2.

Surety Undertaking on a stamp paper of ₹ 2.

I, ...S/o Shri....., R/o..... New Delhi, do hereby declare that I stand surety to the loan of ₹ ……. /- (Rupees …… only) taken by Mr..... S/o Shri..... I accept that in the event of default on, the payment of instalment or the principal sum (including interest if any) by Mr..... I shall become liable to pay such amounts as are outstanding. In this event, I authorise the Management of The East India Hotels Ltd to deduct such amount from my monthly salary or from my terminal dues (including Gratuity, Bonus, etc.) as and when I leave the services of the Company.

Surety Witness:

Dated:

7.5 Meaning of Indemnity

Sections 124 and 125 provide for a contract of indemnity. Section 124 provides that a contract of indemnity is a contract whereby one party promises to save the other from loss caused to him (the promisee) by the conduct of the promisor himself or by the conduct of any other person. A contract of insurance is a glaring example of such type of contracts.

A contract of indemnity may arise either by (i) an express promise or (ii) operation of law, e.g., the duty of a principal to indemnify an agent from consequences of all lawful acts done by him as an agent. The contract of indemnity, like any other contract, must have all the essentials of a valid contract. These are two parties in a contraction of identity indemnifier and indemnified. The indemnifier promises to make good the loss of the indemnified (i.e., the promisee).

Example: A contracts to indemnify B against the consequences of any preceding which C may take against B in respect of a certain sum of ₹ 200. This is a contract of indemnity.

Note Indemnification is a type of insurance which protects the one party from the expenses of other. Indemnification clause cannot usually be enforced for intentional tortious conduct of the protected party.

7.5.1 Rights of the Indemnified (i.e., the Indemnity Holder)

He is entitled to recover from the promisor: (i) All damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies; (ii) All costs of suit which he may have to pay to such third party, provided in bringing or defending the suit

Notes

(a) he acted under the authority of the indemnifier or (b) if he did not act in contravention of orders of the indemnifier and in such a way as a prudent man would act in his own case; (iii) All sums which may have been paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the indemnifier and was one which it would have been prudent for the promisee to make.

7.5.2 Rights of the Indemnifier

The Act makes no mention of the rights of indemnifier. However, his rights, in such cases, are similar to the rights of a surety under s.141, viz, he becomes entitled to the benefit of all the securities which the creditor has against the principal debtor whether he was aware of them or not.

7.5.3 Commencement of Indemnifier's Liability

Indemnity requires that the party to be indemnified shall never be called upon to pay. Indemnity is not necessarily given by repayment after payment. The indemnified may compel the indemnifier to place him in a position to meet liability that may be cast upon him without waiting until the promisee (indemnified) has actually discharged it.

Task B, the proprietor of a newspaper, publishes at A's request libel upon C, in the paper. "A" promises to indemnify B against the consequences of the publication and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages and also incur expenses. Is a liable to make the loss to B? [***Hint:*** A is liable].

7.5.4 Distinction between a Contract of Guarantee and a Contract of Indemnity

L.C. Mather in his book "Securities Acceptable to the Lending Banker" has very briefly, but excellently, brought out the distinction between indemnity and guarantee by the following illustration. A contract in which *A* says to *B*, 'If you lend £20 to *C*, I will see that your money comes back' is an indemnity. On the other hand undertaking in these words, "If you lend £20 to *C* and he does not pay you, I will is a guarantee. Thus, in a contract of indemnity, there are only two parties, indemnifier and indemnified. In case of a guarantee, on the other hand, there are three parties, the 'principal debtor', the 'creditor' and the 'surety'. Other points of difference are:

Table 7.1: Differences between Contract of Indemnity and Contract of Guarantee

Contract of indemnity	Contract of guarantee
A contract of indemnity is a contract by which one party promises to save the other form the loss caused to him by the conduct of the promisor or another person.	A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default.
The liability of the promisor is primary there is no secondary liability.	The liability of principal debtor is primary and the liability of surety is secondary.
The contract is express and specific.	The contract between principal debtor and creditor is specific and between the principal debtor and surety is implied.
There are two parties involved and only one agreement.	There are three parties involved and three agreements.
The promisor cannot file the suit against third person untill and unless the promise subrogates his right for filling a suit.	The surety does not require any subrogation for filing of suit.

Notes

Task P contracts to indemnify R against the consequences of the proceedings which S might take against R in respect of a debt due by R. S obtains judgement against R for the amount. Without paying any portion of the decreed amount, R sues P for its recovery. Decide. [***Hint:*** R can claim the amount from P before having actually paid the same.]

Caselet

United India Insurance Co. Ltd. vs. Manubhai Dharmshibhai Gajera

Insured availed indemnity under 1st mediclaim cover-obtained subsequent mediclaim cover with enhanced amount-second cover amounted o renewal of old mediclaim policy:

The insured had taken a mediclaim policy with the above insurer for a sum of ₹55000/- for the period 1-7-98 to 30-6-99 and the insured availed of indemnity under the said policy in respect of the angioplasty undergone by him during November and December 1998. The insured again took a mediclaim policy in January 1999 for ₹2.5 lacs in which it was duly disclosed the ailment of heart and angioplasty having been undergone under the previous policy. Inspite of this fact the insurer issued a new policy for ₹2.5 lacs. The insured thereafter had undergone angiography and bye-pass surgery in April 1999 and he remained hospitalized between 17-4-99 to 26-4-99. It was this operation which resulted into submission of the claim in question to the insurer. The insurer repudiated the claim on the ground of exclusion clause being operative. The insured filed a complaint with the district forum which allowed the same with an order directing the insurer to pay ₹151845/- to the insured/complainant. The insurer preferred a appeal against the order with the state commission. The said exclusion clause read: "all diseases, injuries which are preexisting when the cover incepts for the first time". It was submitted that the new policy for ₹2.5 lacs taken by the insured was fresh policy and therefore the pre-existing ailment of heart was excluded. The court observed that at least to the extent of ₹55000/- for which insured already had cover, the second cover amounted to the renewal of the mediclaim policy or it can well be said that the cover did not incept for the first time to that extent.

Held: The court directed the insurer to pay the complainant ₹55000/- with interest @10% p.a. with costs ₹1250/- within 8 weeks of the order.

7.6 Summary

- Contract of guarantee is defined as "a contract to perform the promise, or discharge the liability, of a third person in case of his default".
- The person who gives the guarantee is called 'surety'; the person for whom the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given is called the 'creditor'.
- A contract of guarantee may be either oral or in writing. Oral or written, specific and continuing guarantee are the kinds of guarantee.
- The creditor is entitled to demand payment from the surety as soon as the principal debtor refuses to pay or makes default in payment.

Notes

- The liability of the surety cannot be postponed till all other remedies against the principal debtor have been exhausted.
- Contract of indemnity is a contract whereby one party promises to save the other from loss caused to him (the promisee) by the conduct of the promisor himself or by the conduct of any other person.
- The liability of the surety is co-extensive with that of the principal debtor.
- A surety is discharged from liability: (i) by revocation, (ii) by conduct of creditor, or (iii) by invalidation of contract.

7.7 Keywords

Continuing guarantee: A guarantee which extends to a series of transactions.

Contract of guarantee: It is a contract to perform the promise, or discharge the liability, of a third person in case of his default.

Contract of indemnity: It is a contract of indemnity is a contract whereby one party promises to save the other from loss caused to him by the conduct of the promisor himself.

Co-surety: When a debt is guaranteed by two or more sureties, they are called co-sureties.

Creditor: The person to whom the guarantee is given.

Principal debtor: The person for whom the guarantee is given.

Specific guarantee: It extends to a single transaction or debt.

Surety: The person who gives the guarantee.

7.8 Self Assessment

State whether the following statements are true or false:

1. As per the Indian law, a contract of guarantee must be in writing.
2. Specific guarantee is different from continuing guarantee.
3. For a contract of guarantee, the primary liability is of the surety.
4. In the event of principal debtor being a minor, creditor cannot recover his money from the surety.
5. The liability of a surety is secondary.
6. The surety is a favoured debtor.
7. Between co-sureties there is equality of burden and benefit.

Fill in the blanks:

8. ..... is a contract to perform the promise, or discharge the liability, of a third person in case of his default.
9. ..... is a contract of indemnity is a contract whereby one party promises to save the other from loss caused to him by the conduct of the promisor himself.
10. ..... *is a* guarantee which extends to a series of transactions.
11. When a debt is guaranteed by two or more sureties, they are called ..... .

7.9 Review Questions

Notes

1. What do you understand by the contract of guarantee?
2. "The liability of a surety is secondary and co-extensive with that of principal debtor." Comment.
3. What is a 'continuing guarantee'? When can it be revoked?
4. Describe the rights of a surety against (i) co-sureties and (ii) the creditor.
5. Explain the circumstances under which a surety may be discharged from the liability by the conduct of the creditor.
6. Define the contract of 'Indemnity'. Describe the rights of the indemnifier and the indemnity-holder.
7. "Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay." Discuss.
8. Distinguish between a contract of guarantee and a contract of indemnity.

Answers: Self Assessment

1. False
2. True
3. False
4. True
5. True
6. True
7. True
8. Contract of guarantee
9. Contract of indemnity
10. Continuing guarantee
11. Co-sureties

7.10 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

M.C.Kuchhal, "*Business Law*", Vikas Publishing House.

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S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

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http://legalservicesindia.com/article/userarticles.php?aut_id=301

http://www.lawyersclubindia.com/articles/IS-Contract-of-Insurance-a-contract-of-indemnity--3536.asp

Notes

Unit 8: Contract of Bailment and Pledge

CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss bailment and kinds of bailment
- State duties of bailee
- Describe pledge as a special kind of bailment
- Explain rights and duties of pawnee's and pawners

Notes

Introduction

In last unit, you studied about contract of guarantee and contract of indemnity. At one time or another, we enter into a legal relationship, called bailment and pledge. Bailments are quite common in business also. Traders often store their surplus goods in warehouses; and utilize the services of cold storages for keeping their goods to be taken back as and when required; and factory owners often send machinery back to vendors for repairs. Also, goods are pledged for securing loans. The sections quoted in this unit refer to the Indian Contract Act, 1872.

8.1 Definition of Bailment and its Kinds

Let us first understand the term bailment.

8.1.1 Definition of Bailment (S.148)

Bailment is defined as the "delivery of goods by one to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of person delivering them". The person delivering the goods is called the 'bailor' and the person to whom the goods are delivered is called the 'bailee'. The explanation to the above Section points out that delivery of possession is not necessary, where one person, already in possession of goods contracts to hold them as bailee.

The bailee is under an obligation to re-deliver the goods, in their original or altered form, as soon as the time of use for, or condition on which they were bailed, has elapsed or been performed.

Let's illustrate, (i) *A* delivers some clothes to *B*, a dry cleaner, for dry cleaning. (ii) *A* delivers a wrist watch to *B* for repairs. (iii) A lends his book to *B* for reading. (iv) *A* delivers a suit-length to a tailor for stitching. (v) *A* delivers some gold biscuits to *B*, a jeweler, for making jewellery. (vi) Delivery of goods to a carrier for the purpose of carrying them from one place to another. (vii) Delivery of goods as security for the repayment of loan and interest thereon, i.e., pledge.

From the definition of bailment, the following characteristics should be noted:

1. ***Delivery of goods:*** The essence of bailment is delivery of goods by one person to another for some temporary purpose. Delivery of goods may, however, be actual or constructive. Actual delivery may be made by handing over goods to the bailee. Constructive delivery may be made by doing something which has the effect of putting the goods in the possession of the intended bailee or any person authorized to hold them on his behalf (s.149).

Example:

(i) A, holding goods on behalf of B, agrees to hold them on behalf of C, there is a constructive transfer of possession from C to A.

(ii) A an owner of a scooter, sells it to B, who leaves the scooter in the possession of A. A becomes a bailee, although originally he was the owner.

It needs to be noted that bailment is concerned with goods only. Current money, i.e., the legal tender (but not old and rare coins) are not goods. A 'deposit of money', therefore, is not bailment.

Bailment is based on a contract. In bailment, the delivery of goods is upon a contract that when the purpose is accomplished, they shall be returned to the bailor. For example, where a watch is delivered to a watch repairer for repair, it is agreed that it will be returned, after repair, on the receipt of the agreed or reasonable charges.

Though bailment is usually based on a contract, there are certain exceptions, e.g., the case of a finder of lost goods. The finder of lost goods is treated as a bailee of the lost article, though obviously, there is no contract between the finder and the real owner (s.168).

Notes

3. ***Return of goods in specie:*** The goods are delivered for some purpose and it is agreed that the specific goods shall be returned. Return of specific goods (in specie) is an essential characteristic of bailment. Thus, where an equivalent and not the same is agreed to be returned, there is no bailment.

4. ***Ownership of goods:*** In a bailment, it is only the possession of goods which is transferred and not the ownership thereof, therefore the person delivering the possession of goods need not be the owner; his business is to transfer possession and not ownership.

Note In *United Breweries Ltd v/s State of Andhra Pradesh* (1997), 3 SCC 530: 1997 AIR SCW 1414, the appellants sold beer in bottles to the customers. The customers were required to pay cost of beer and to deposit a sum for bottle which was refundable. The customers were advised to collect empty bottles from the consumers and return them to the appellants and get back their deposit for the bottles. Supreme Court held that there was no sale of bottles but in clear terms it was bailment.

8.1.2 Kinds of Bailments

Bailments may be, classified into six kinds as follows:

1. ***Deposit:*** Delivery of goods by one person to another for the use of the former, i.e., bailor;
2. ***Commodatum:*** Goods lent to a friend *gratis* to be used by him;
3. ***Hire:*** Goods lent to the bailee for hire, i.e., in return for payment of money;
4. ***Pawn or Pledge:*** Deposit of goods with another by way of security for money borrowed;
5. Delivery of goods for being transported, or something to be done about them, by the bailee for reward.
6. Delivery of goods as in (5) above, but without reward.

8.2 Duties and Rights of Bailor and Finder of Goods

After understanding term bailment, let us start with duties and right of parties involved in bailment. These parties are bailor and bailee. Bailee is also termed as finder of goods.

8.2.1 Duties of a Bailor

1. ***To disclose know faults in the goods (s.150):*** The bailor is bound to disclose to the bailee faults in the goods bailed, of which the bailor is aware and which materially interfere with the use of them or expose the bailee to extraordinary risks. If he does not make such disclosure, he is responsible for the damage arising to the bailee directly from such faults.

   If the goods are bailed for hire or reward, the bailor is responsible for such damage whether he was or was not aware of the existence of such faults in goods bailed.

Example:

(i) A lends a horse, which he knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away. B is thrown and injured. A is responsible to B for damage sustained.

(ii) A hires a carriage of B. The carriage is unsafe though B is not aware of it. A is injured. B is responsible to A for injury.

Notes

2. ***Liability for breach of warranty as to title:*** The bailor is responsible to the bailee for any loss which the bailee may sustain by reason that the bailor was not entitled to make the bailment, or to receive back the goods or to give directions respecting them (s.164).

Example: A gives B's car to C without B's knowledge and permission. B sues C and receives compensation. A, the bailor, is responsible to make good this loss to C, the bailee.

3. ***To bear expenses in case of gratuitous bailments:*** Regarding bailments under which bailee is to receive no remuneration, s.158 provides that in the absence of a contract to the contrary, the bailor must repay to the bailee all necessary expenses incurred by him for the purpose of the bailment.

   In case of non-gratuitous bailments, the bailor is held responsible to bear only extraordinary expenses.

Example: A car is lent for a journey. The ordinary expenses like petrol, etc., shall be borne by the bailee but in case the car goes out of order, the money spent in its repair will be regarded as an extraordinary expenditure and borne by the bailor.

8.2.2 Duties of a Finder of Goods

Duties of a finder of goods are as follow:

1. ***To take care of the goods bailed (s.151):*** In all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

   In case, bailee has taken the amount of care as described above, he shall not be responsible, in the absence of any special contract, for the loss, destruction or deterioration of the thing bailed (s.152).

2. ***Not to make unauthorized use of goods (s.154):*** In case the bailee makes unauthorized use of goods, i.e., uses them in a way not warranted by the terms of bailment, he is liable to make compensation to the bailor for any damages arising to the goods from or during such use of them.

Examples:

(i) A lends a car to B for his own driving only. B allows C, his wife, to drive the car. C drives with care, but the car is damaged in an accident. A is liable to make compensation to B for the damage done to the car.

(ii) A hires a car in Calcutta from B expressly to drive to Varanasi. A drives with due care, but drives to Cuttack instead. The car meets with an accident and is damaged. B is liable to make compensation to A for the damage to the car.

3. ***Not to mix bailor's goods with his own (Ss. 155-157):*** If the bailee without the consent of the bailor, mixes the goods of the bailor with his own goods and the goods can be separated or divided, the bailee shall be bound to bear the expense of separation or division and any damages arising from the mixture.

Example: A bails 100 bales of cotton marked with a particular mark to B.B., without A's consent, mixes the 100 bales with other bales of his own bearing a different mark. A is entitled to have his 100 bales returned and B is bound to bear all expenses incurred in the separation of the bales and any other incidental damage.

Notes

But in case goods are mixed in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods.

Example: A bails a barrel of flour worth ₹ 450 to B. B without A's consent mixes the flour with flour of his own, worth only ₹ 250 a barrel. B must compensate A for the loss of his flour.

4. ***To return the goods bailed without demand (s.160):*** It is the duty of the bailee to return, or deliver according to the bailor's directions, the goods bailed, without demand, as soon as the time for which they were bailed has expired, or the purpose, for which they were bailed has been accomplished.

   If bailee fails to return the goods at the proper time, he is responsible to the bailor for any loss, destruction or deterioration of the goods from that time (s.161).

5. ***To return any accretion to the goods bailed (s.163):*** In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed.

Example: A leaves a cow in the custody of B to be taken care of. The cow gives birth to a calf. B is bound to deliver the cow as well as the calf to A.

6. ***Not to question the title of bailor (s.167):*** In cases of conflicting claims as to title to the goods are to be decided by the court and unless the court grants an injunction against the delivery of goods to the bailor, the bailee is under duty to return it to bailor at proper time or within the reasonable time.

Task A customer entrusts certain important documents for safe custody to his bank. The bank keeps the documents in a wooden box. Later it is found that the documents were destroyed by white ants. What is the bank's liability to the customer? [***Hint:*** Ss. 151-152.]

8.2.3 Rights of a Bailee

Following are the rights of a Bailee:

1. The duties of the bailor are, in fact, if looked from the point of view of bailee, the bailee's rights. Thus, a bailee can sue bailor for (a) claiming compensation for damages resulting from non-disclosure of faults in the goods; (b) for breach of warranty as to the title and the damage resulting therefrom; and (c) for extraordinary expenses. Thus in the case of wrongful deprivation the bailee has a right to use the same remedies which the owner might have used in the like case.

2. ***Another right of bailee is the right of lien (Ss. 170-171):*** Lien is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is paid, Lien, thus presupposes two things; (i) The person vested with the right of lien is in possession of the goods or securities in the ordinary course of business. (ii) The owner (bailor in this case) has a lawful debt due or obligation to discharge to the person in possession of the said goods or securities (bailee in this case). Since, lien is available only until the debt or claim is satisfied, once the debt is satisfied or obligation discharged, the right of lien is extinguished. The property so retained has, then, to be returned to or kept at the disposal of the owner (i.e., bailor). Lien may be of two types: (i) General Lien and (ii) Particular Lien.

Notes

General Lien means the right to retain goods not only for demands arising out of the goods retained but for a general balance of account in favour of certain persons. Particular Lien, on the other hand, means the right to retain the particular goods in respect of which the claim is due. Bailee's right of lien is particular in certain cases whereas general in other cases. Particular Lien is conferred upon a bailee by virtue of the provisions of s. 170. It reads: "Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods until he receives due remuneration for the service he has rendered in respect of them".

Examples:

(i) A delivers a rough diamond to B, a jeweller, to be cut and polished, which is accordingly done. B is entitled to retain the stone till he is paid for the services he has rendered.

(ii) A gives cloth to B, a tailor, to make into a coat. B promises A to deliver the coat as soon as it is finished and to give a three months' credit for the price. B is not entitled to retain the coat until he is paid.

The provisions of s.171 empower certain categories of bailees to exercise a general lien. These include: bankers, factors, wharfinger, and attorneys of High Court and policy brokers. These bailees can retain all goods of the bailor so long as anything is due to them, unless there is a contract to the contrary.

3. ***Right against wrongful deprivation of or injury to goods (Ss.180-181):*** If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or causes them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made and either the bailor or the bailee may bring a suit against the third person for such deprivation or injury. Now, whatever is obtained by way of relief or compensation in such a suit shall, as between the bailor and the bailee, be dealt with according to their respective interest (s.181).

8.2.4 Rights of a Bailor

There is number of rights of a Bailor. These are:

1. The bailor can enforce, by suit, all duties or liabilities of the bailee.
2. In case of gratuitous bailment (i.e., bailment without reward), the bailor can demand their return whenever he pleases, even though he lent it for a specified time or purpose. But if, on the faith of such bailment, the borrower has acted in such a manner that the return of the thing before the specified time would cause him (i.e., the bailee) loss exceeding the benefit derived by him from the bailment, the bailor must indemnify the borrower for the loss if he compels an immediate return (s.159).

Task A consigned goods by Railways. The consignment, at the time of delivery, was found damaged. After obtaining a certificate of damages from the Railway Officer, A claimed from the Railways compensation of ₹ 2,300. The general Manager of the Railways sent him a cheque for ₹ 1,300 in full and final settlement. The cheque was encashed, but after a lapse of sometime. A claimed that the payment had satisfied only a part of his claim and demanded payment of the balance. Discuss the claim of A for payment of the balance amount. [***Hint:*** A shall have no claim against Railways.]

Notes

8.3 Termination of Bailment

A contract of bailment terminates or comes to an end under the following circumstances:

1. ***On the expiry of the stipulated period:*** Where bailment is for a specific period, it comes to an end on the expiry of the specified period.

Example: A room cooler is hired by X from Y for a period of 6 months. On the expiry of 6 months X must return the cooler.

2. ***On the accomplishment of the specified purpose:*** In case, bailment is for specific purpose it terminates as soon as the purpose is accomplished.

Examples:

(i) A suit length is given to a tailor to be stitched into a suit. The tailor is bound to return it as soon as the cloth is stitched into suit.

(ii) A hires from B certain tents and crockery on marriage of his daughter. The same must be returned as soon as marriage is accomplished.

3. ***By bailee's act inconsistent with conditions of bailment:*** If the bailee does any act with regard to the goods bailed, inconsistent with the conditions of the bailment, the bailor may terminate the bailment (s.153).

Example: A lets to B for hire a horse for his own riding. B drives the horse in his carriage. A shall have the option to terminate the bailment.

4. ***A gratuitous bailment may be terminated at any time (s.159):*** However, if premature termination causes any loss to the bailee exceeding the benefit derived from the bailment, the bailor must indemnify. Further, a gratuitous bailment terminates by the death of either the bailor or the bailee (s.162).

8.4 Finder of Lost Goods

Finding is not owning. A finder of lost goods is treated as the bailee of the goods found as such and is charged with the responsibilities of a bailee, besides the responsibility of exercising reasonable efforts in finding the real owner. However, he enjoys certain rights also. His rights are summed up hereunder.

8.4.1 Right to Retain the Goods (S.168)

A finder of lost goods may retain the goods until he receives the compensation for money spent in preserving the goods and/or amount spent in finding the true owner. A finder, however, cannot sue for such compensation. But where, a specific reward has been offered by the owner for the return of the goods lost, the finder may sue for such reward and may retain the goods until he receives it.

8.4.2 Right to Sell (S.169)

When a thing which is commonly the subject of sale is lost, if the owner cannot with reasonable diligence be found or if he refuses, upon demand, to pay the lawful charges of the finder, the finder may sell it. (i) when the thing is in danger of perishing or of losing the greater part of its value; (ii) when the lawful charges of the finder in respect of the thing found, amount to two-third of its value.

Notes

Task X lends his car to Y for going to attend the annual general meeting of ABC Limited, being held at Juhu, a place in Mumbai. The brakes of the car are not in working order. This fact is already known to X, but he did not tell Y about the defect. Y holds a valid driving licence. Y, instead of going to attend the annual general meeting at Juhu, drives the car to the Gateway of India on a pleasure trip. The car meets with an accident and Y gets injured. Y wants to hold X liable for the injury. Decide whether Y would succeed? [***Hint:*** Y would not succeed s.154.].

8.5 Pledge as a Special Kind of Bailment

Section 172, defines a pledge as the bailment of goods as security for payment of a debt or performance of a promise. The person, who delivers the goods as security, is called the 'pledgor' and the person to whom the goods are so delivered is called the 'pledgee'. The ownership remains with the pledgor. It is only a qualified property that passes to the pledgee. He acquires a special property and lien which is not of ordinary nature and so long as his loan is not repaid, no other creditor or 'authority' can take away the goods or its price. Thus, in *Bank of Bihar v. State of Bihar and Ors*. (1971) Company Cases 591, where sugar pledged with the Bank was seized by the Government of Bihar, the Court ordered the State Government of Bihar to reimburse the bank for such amount as the Bank in the ordinary course would have realized by the sale of sugar seized.

8.5.1 Delivery Essential

A pledge is created only when the goods are delivered by the borrower to the lender or to someone on his behalf with the intention of their being treated as security against the advance. Delivery of goods may, however, be actual or constructive. It is constructive delivery where the key of a godown (in which the goods are kept) or documents of title to the goods are delivered. The owner of the goods can create a valid pledge by transferring to the creditor the documents of title relating to the goods.

Example: A businessman pledged a railway receipt to a bank, duly endorsed. Later he was declared bankrupt. The Official Assignee contended that the pledge of the railway receipt was not valid. Held, that the railway receipts in India are title to goods, and that the pledge of the railway receipt to the bank, duly endorsed, constituted a valid pledge of the goods.

Similarly, where the goods continue to remain in the borrower's possession but are agreed to be held as a 'bailee' on behalf of the pledgee and subject to the pledgee's order, it amounts to constructive delivery, and is a valid pledge.

8.5.2 Advantages of Pledge

To a creditor, pledge is perhaps the most satisfactory mode of creating a charge on goods. It offers the following advantages:

1. The goods are in the possession of the creditor and therefore, in case the borrower makes a default in payment, they can be disposed of after a reasonable notice.
2. Stocks cannot be manipulated as they are under the lender's possession and control.
3. In the case of insolvency of the borrower, lender can sell the goods and prove for the balance of the debt, if any.

Notes

4. There is hardly any possibility of the same goods being charged with some other party if actual possession of the goods is taken by the lender.

8.6 Pledges by Non-owners

The general rule is that it is the owner of the goods who can ordinarily create a valid pledge. However, in the following cases, even a pledge by non-owners shall be valid:

1. ***Pledge by a mercantile agent:*** Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were expressly authorized by the owner of the goods to make the same. Such a pledge shall, however, be valid only if the Pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has no authority to pledge (s.178)

   A 'mercantile agent' as per s.2(9) of the Sale of Goods Act, 1930, means a mercantile agent having, in the customary course of business as such agent, authority either to sell goods or to consign goods for the purpose of sale or to buy goods or to raise money on the security of goods. For a pledge by a mercantile agent to be valid the following conditions must be satisfied:

   (a) *Good faith:* The pledgee must have acted in good faith and must not have at the time of the pledge notice that the pawnor had no authority to pledge the goods. The onus of proving both these facts rests upon the person disputing the validity of the pledge.

   (b) *Acting in the ordinary course of business:* The mercantile agent must have acted in the ordinary course of his business. Therefore, if he does the business outside his business premises or out of business hours, such a transaction would fall outside this section.

2. ***Pledge by seller or buyer in possession after sale:*** Under s.30 of the Sale of Goods Act, a seller left in possession of goods after sale, and a buyer, who obtains possession of goods with the consent of the seller, before sale, can create a valid pledge. Once again, for the pledge to be valid the pledgee should have acted in good faith and without notice of previous sale of goods to the buyer or of the lien of the seller over the goods.

3. ***Pledge by a person in possession under a voidable contract (s.178-A):*** Where a person obtains possession of goods under a voidable contract the pledge created by him is valid provided: (a) the contract has not been rescinded before the contract of pledge and (b) the pawnee acts is good faith and without notice of the pawnor's defect of title.

4. ***Pledge by co-owner in possession:*** One of several joint owners of goods in sole possession thereof with the consent of the rest may make a valid pledge of the goods.

5. ***Pledge by a person having limited interest (s.179):*** Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of the interest. Thus, a pledgee may further pledge goods to the extent of the amount advanced thereon.

8.7 Rights and Duties of a Pawner and a Pawnee

According to s.176 in case the pledgor fails to pay his debt or complete the performance of obligation at the stipulated time, the pledgee can exercise any of the following right:

1. Bring a suit against the pledgor upon the default in redemption of the debt or performance of promise and retain possession of goods pledged as a collateral security; or

2. Sell the goods pledged on giving the pledgor a reasonable notice of sale.

Notes

In case the goods pledged when sold do not fully meet the amount of the debt, the pledgee can proceed for the balance. If, on the other hand, there is any surplus, that has to be accounted for to the pledgor. Before sale can be executed, a reasonable notice must be given to the pledgor so that:

1. The pledgor may meet his obligation as a last chance;
2. He can supervise the sale to see that it fetches the right price.

Example: A trader pledged certain goods in favour of a bank. On default to return the loan, the bank sold the goods without giving a notice of sale to the trader as the loan agreement specifically excluded it. Held, that such an exclusion clause is inconsistent with the provisions of the Act and as such void and unenforceable.

However, the sale made by the pledgee without giving a reasonable notice to the pledgor is not void, i.e., cannot be set aside. The pledgee will be liable to the pledgor for the damages.

8.7.1 Rights of Pledgee

In addition to the rights mentioned in s.176, a pledgee has the following rights:

1. It is the duty of the pledgor to disclose any defects or faults in the goods pledged which are within his knowledge. Similarly, if the goods are of an abnormal character says explosives or fragile, the pledgee must be informed. In case the pledgor fails to inform such faults or abnormal character of the goods pledged, any damage as a result of non-disclosure shall have to be compensated by the pledgor.
2. The pledgee has a right to claim any damages suffered because of the defective title of the pledgor.
3. A pledgee's rights are not limited to his interests in the pledged goods. In case of injury to the goods or their deprivation by a third party, he would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd v. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only ₹ 20,000 – the amount due to it, but the full value of the consignment, i.e., ₹ 35,000. However, the amount over and above his interest is to be held by him in trust for the pledgor.
4. ***Pawnee's right of retainer [s.173]:*** The Pawnee may retain the goods pledged, not only for payment of the debt or the performance of the promise, but for the interest of the debt and all necessary expenses incurred by him in respect of the possession or for the preservation of the goods pledged. However, s.174 provides that the Pawnee shall not, in the absence of a contract to that effect, retain the goods pledged for any debt or promise other than the debt or promise for which they are pledged; but such contract, in the absence of anything to the contrary, shall be presumed in regard to subsequent advances made by the Pawnee.
5. A pledgee has a right to recover any extraordinary expenditure incurred for preservation of the goods pledged (s.175).

8.7.2 Duties of a Pledgee

Duties of pledgee are as follows:

1. The pledgee is required to take as much care of the goods pledged to him as a person of ordinary prudence would, under similar circumstances, take of his own goods, of a similar nature.
2. The pledgee must not put the goods to an unauthorized use.

Notes

3. The pledgee is bound to return the goods on payment of the debt.
4. Any accruals to the goods pledged belong to the pledgor and should be delivered accordingly. Thus, if the security consists of equity shares and the company issues bonus shares to the equity shareholders, the bonus shares are the property of the pledgor and not the pledgee.

8.7.3 Duties of a Pledgor

There are number of duties of a pledgor. These are:

1. He must disclose to the pledgee any material faults or extraordinary risks in the goods to which the pledgee may be exposed.
2. He is responsible to meet any extraordinary expenditure incurred by the pledgee for the preservation of the goods.
3. Where the pledgee has exercised his right of sale of goods, any shortfall has to be made good by the pledgor.
4. He is liable for any loss caused to the pledgee because of defects in his (pledgor's) title to the goods.

8.7.4 Rights of a Pledgor

There are number of rights of a pledgor. These are:

1. The pledgor has a right to claim back the security pledged on repayment of the debt with interest and other charges.
2. He has a right to receive a reasonable notice in case the pledgee intends to sell the goods, and in case he does not receive the notice he has a right to claim any damages that may result.
3. In case of sale, the pledgor is entitled to receive from the pledgee any surplus that may remain with him after the debt is completely paid off.
4. The pledgor has a right to claim any accruals to the goods pledged.
5. If any loss is caused to the goods because of mishandling or negligence on the part of the pledgee, the pledgor has a right to claim the same.

Task X, a warehouseman, was entrusted with certain goods for safe custody. X had taken reasonable precautions for the safety of the goods by providing a safe building, safe locks and a competent watchman. But the goods were lost due to the negligence of the watchman who probably did not lock or watch properly. X denies his liability urging that there was no negligence on his part. Decide the question of X's liability. [***Hint:*** X is liable to compensate the bailor for the negligence of X's servant.].

Notes

Case Study

Pfizer's

It would have been business as usual at multinational drug-maker *Pfizer's* annual shareholder meeting, but for a dissenting LIC representative who opposed two enabling proposals to increase the salary of the managing director and the commission of two Indian non-executive directors, respectively.

LIC totally holds 14.38 per cent in Pfizer, and the LIC representative told that he was communicating the decision taken by the corporation. He was, however, unable to give reasons behind the decision. Market observers indicated that LIC could push for a poll on the proposal, given its equity holding.

One of the enabling resolutions was regarding Pfizer's Managing Director in India, Mr. Kewal Handa's salary, proposing that it be increased from its 2007-level of ₹ 1.80 crores to a maximum of ₹ 2.50 crores a year.

The other enabling resolution was with reference to resident non-executive directors Mr. R.A. Shah and Mr. Pradip Shah, seeking to raise their commission, at the rate of one per cent of the company's profit, up to ₹ 50 lakh a year.

The company explained that the commission for non-executive directors was upped to ₹ 20 lakhs a year in 2004, effective for a five-year period starting December 2003.

Shareholders should be part of the good and bad times of the company, said a shareholder who has been holding a Pfizer share since the beginning, when the multinational sent letters to shareholders inviting them into their fold.

He, along with some other shareholders, were expressing their unhappiness over the dividend. The dividend for the year ended 2008 was ₹ 12.50 per share, as compared with the previous year's ₹ 27.50 per share. However, Pfizer's Chairman, Mr. R.A. Shah, clarified that there were no motives behind the company's actions and dividends were generous when the circumstances warranted it.

On Pfizer Inc's recently announced plan to raise stake in its Indian subsidiary to 75 per cent, from the present 41 per cent, he said, that there was no intention to delist, "at this time".

Unlike info-tech companies, he said, the applicable milestone for Pfizer for reverse book building was 75 per cent. Creeping acquisition and buy-back was allowed only till 75 per cent, he clarified. Also, he said, Pfizer was also evaluating the possibility of merging Duchem (that has pharma and animal health businesses) with itself.

Detailing Pfizer's plans to expand its domestic reach, Mr. Handa said that they would increase the product portfolio and value offerings from the company. The company was planning to increase its field force by 300 people, including 100 for just retail sales.

Question

Discuss LIC's role in Pfizer. (***Hint:*** Summarize the LIC responsibilities in Pfizer.)

8.8 Summary

- In this unit, you studied about the bailment and pledge.
- Bailment is defined as the "delivery of goods by one to another person for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of person delivering them".

Notes

- The person delivering the goods is called the 'bailor' and the person to whom the goods are delivered is called the 'bailee'.
- Lien is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is paid.
- A pledge as the bailment of goods as security for payment of a debt or performance of a promise.
- The person, who delivers the goods as security, is called the 'pledgor' and the person to whom the goods are so delivered is called the 'pledgee'.
- A pledgee has a right to recover any extraordinary expenditure incurred for preservation of the goods pledged.
- The pledgee is required to take as much care of the goods pledged to him as a person of ordinary prudence would, under similar circumstances, take of his own goods, of a similar nature.
- The pledgee is bound to return the goods on payment of the debt.

8.9 Keywords

General Lien: The right to retain goods not only for demands arising out of the goods retained but for a general balance of account in favour of certain persons.

Particular Lien: The right to retain the particular goods in respect of which the claim is due.

Pledgee: The person to whom the goods are so delivered.

Pledgor: The person, who delivers the goods as security.

8.10 Self Assessment

State whether the following statement are true or false:

1. Delivery of goods is essential for effecting bailment.
2. Placing of ornaments in a bank locker is not a contract of bailment.
3. Bailee need not return to the bailor any accretion to the goods on completion of the contract of bailment.
4. A finder may sell goods when they are in danger of perishing or losing the greater part of their value.
5. The ownership of goods bailed passes to the bailee.

Fill in the blanks:

6. A ..... bailment can be terminated by the bailor even before the stated time.
7. The right to retain goods not only for ..... arising out of the goods retained but for a general balance of account in favour of certain persons.
8. A ..... as the bailment of goods as security for payment of a debt or performance of a promise.
9. The person delivering the goods is called the 'bailor' and the person to whom the goods are delivered is called the ..... .
10. ..... is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is paid.

Notes

8.11 Review Questions

1. Define bailment. What are the requisites of a contract of bailment? Explain.
2. Distinguish between 'gratuitous bailment' and 'bailment for hire'.
3. "Bailee's right of lien is a particular lien and does not extend to other goods of the bailor in his possession." Comment.
4. Discuss the characteristics of a pledge.
5. What are the respective rights and duties of a pawnor and a pawnee?
6. When is a pledge created by non-owners valid?
7. "Bailor is liable to the bailee for loss caused by faults in the goods bailed whether the bailor was aware of the same or not." Comment.
8. "Bailor must compensate the bailee for all expenses." Comment.
9. "The finder of lost goods has no right to file a suit for recovery of expenses incurred by him for finding out the true owner." Discuss.
10. When a pledgor fails to redeem his pledge, what rights does the pledgee have in the pledge?
11. "Every pledge is a bailment, but every bailment is not a pledge". Discuss.

Answers: Self Assessment

1.	True	2.	True
3.	False	4.	True
5.	False	6.	Gratuitous
7.	Demands	8.	Pledge
9.	'Bailee'	10.	Lien

8.12 Further Readings

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Unit 9: Law of Agency

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Contd...

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Objectives

After studying this unit, you will be able to:

- Define agency and agent
- Explain different kinds of agencies
- Discuss right and liability of agent and principle
- Describe termination of agency and its modes

Introduction

In the previous unit, you came to know about the bailment and guarantee of contract. In this unit you will study about the contract of agency.

Before the Industrial revolution, business was carried on largely by individual artisans in their homes and in small family operated shops. As population and trade expanded and division of labour and specialisation became the order of the day, there arose the problem of distribution of goods. To meet the rising demand, manufacturers and shopkeepers began to hire others to work for them. These helpers or "servants" as they were called performed whatever physical tasks were assigned to them, under the close personal supervision of the "master". The Indian Contract Act, 1872, makes provisions as regards agency. Secs.182 to 238 deals with the subject of agency.

9.1 Definition of Agent and Agency

Agent is "a person employed to do any act for another or to represent another in dealings with third person". Thus, agent is a person who acts in place of another. The person for whom or on whose behalf he acts is called the Principal. For instance, Anil appoints Bharat, a broker, to sell his Maruti Car on his behalf. Anil is the Principal and Bharat is his agent. The relationship between Anil and Bharat is called Agency. This relationship is based upon an agreement whereby one person acts for another in transaction with a third person.

The function of agent is to bring about contractual relation between the principal and a third party. The agent is only a connecting link between the principal and the third party and is rightly called as '*conduit pipe*'. The acts of the agent, within the scope of the instructions, bind the principal as if he has done them himself. The phrase '*qui facit per alium facit per se*' contains the principle of agency, which means, he who does through another does by himself. In simple words, the act of agent is the act of the principal.

Agent must be distinguished from a servant. A servant acts under the direct control and supervision of his master and is bound to carry out all his reasonable orders. Agent, on the other hand, though bound to exercise his authority in accordance with lawful instructions of the principal is not subject to his direct supervision and control. Agent, therefore, is not a servant; though a servant, May for some purposes, be his master's agent. Further, agent may work for several principals at the same time; a servant usually serves only one master.

Notes

No consideration is necessary to create agency (s. 185). The fact that the principal has consented to be represented by the agent is a sufficient detriment and consideration to support the promise of the agent to act in that capacity. However, in case no consideration has passed to the agent, he is not bound to do the agreed work, but once he begins, he must complete it to the satisfaction of the principal.

9.1.1 Who can Employ Agent?

Any person who is of the age of majority according to the law to which he is subject and who is of sound mind, may employ agent (s.183). No qualifications as such are prescribed for a person to be agent except that he has attained majority and is of sound mind. Thus, a minor or a lunatic cannot contract through agent since they cannot contract themselves personally either. If agent acts for a minor or lunatic, he will be personally liable to the third party. Association or group of persons may also appoint agent; for instance, a partnership firm may, transact business through agent. Certain group of persons, because of the very nature of their organisation, must act through agent, e.g., a company, which is an artificial person and thus can transact business only through agent.

9.1.2 Who may be Agent?

Since agent is a mere connecting link or a '*conduit pipe*' between the principal and the third party, it is immaterial whether or not the agent is legally competent to contract. Thus, there is no bar to the appointment of a minor as agent. However, in considering the contract of agency itself (i.e., the relation between principal and agent), the contractual capacity of the agent becomes important. Thus, no person who is not of the age of majority and of sound mind can become agent, as to be responsible to his principal (s.184). Thus, if the agent happens to be a person incapable of contracting, then the principal cannot hold the agent liable, in case he misconducts or has been negligent in the performance of his duties.

Example: Rahim appoints Kiran, a minor, to sell his car for not less than ₹ 90,000. Kiran sells it for ₹ 80,000. Rahim will be held bound by the transaction and further shall have no right against Kiran for claiming the compensation for having not obeyed the instructions, since Kiran is a minor and a contract with a minor is void ab initio.

9.2 Different Kinds of Agencies

A contract of agency may be created by an express agreement or by implication (implied agreement) or by ratification. Thus, there are different kinds of agency.

9.2.1 Express Agency

A person may be appointed as agent, either by word of mouth or by writing. No particular form is required for appointing agent. The usual form of a written contract of agency is the power of attorney on a stamped paper.

9.2.2 Implied Agency

Implied agency arises from the conduct, situation or relationship of parties. Implied agency, therefore, includes agency by estoppel, agency by holding out and agency of necessity.

Notes

9.2.3 Agency by Estoppel

When a person has, by his conduct or statements, induced others to believe that a certain person is his agent, he is estopped from subsequently denying it. The principal is precluded from denying the truth of agency which he himself has represented as a fact, although it is not a fact.

Examples:

1. Prakash allows Anand to represent as his agent by telling Cooper that Anand is Prakash's agent. Later on, Cooper supplied certain goods to Anand thinking him to be Prakash's agent. Prakash shall be liable to pay the price to Cooper. By allowing Anand to represent himself as his agent, Prakash leads Cooper to believe that Anand is really his agent.
2. Anand owns a shop in Serampur, living himself in Calcutta and visiting the shop occasionally. The shop is managed by Bharat and he is in the habit of ordering goods from Cooper in the name of Anand for the purposes of the shop and of paying for them out of Anand's funds with Anand's knowledge. Bharat has an implied authority from Anand to order goods from Cooper in the name of Anand for the purposes of the shop.

9.2.4 Agency by Holding Out

Though part of the law of estoppel, some affirmative conduct by the principal is necessary in creation of agency by holding out.

Example: Puran allows his servant Amar to buy goods for him on credit from Komal and pay for them regularly. On one occasion, Puran pays his servant in cash to purchase the goods. The servant purchases good on credit pocketing the money. Komal can recover the price from Puran since through previous dealings Puran has held out his servant Amar as his agent.

9.2.5 Agency of Necessity

This arises where there is no express or implied appointment of a person as agent for another but he is forced to act on behalf of a particular person.

Examples:

1. The Master of a ship, which is in distress and requires heavy and urgent repairs, can pledge the ship or cargo (without express or implied authority) and raise money in order to execute the voyage. He will be considered as the agent of the owner by necessity.
2. A horse is sent by rail and at the destination is not taken delivery by the owner. The station master has to feed the horse. He has become the agent by necessity and hence the owner must compensate him.

The doctrine of agency by necessity also extends to cases where agent exceeds his authority provided (a) it was not reasonably possible to get the principal's instructions, (b) the agent had taken all reasonable and necessary steps to protect the interests of the principal and (c) he acted *bona fide*.

9.2.6 Agency by Ratification

Where agent does an act for his principal but without knowledge of authority, or where he exceeds the given authority, the principal is not held bound by the transaction. However, s.196 permits the principal, if he so desires, to ratify the act of the agent. If he so elects, it will have the

Notes

same effect as if the act was originally done by his authority. Agency in such a case is said to be created by ratification. In other words, the agency is taken to have come into existence from the moment the agent first acted and not from the date of principal's ratification. The rule is that every ratification relates back and is equivalent to a previous command or authority.

Example: Lallan makes an offer to Badal, Managing Director of a company. Badal accepts the offer though he has no authority to do so. Lallan subsequently withdraws the offer, but the company ratifies Badal's acceptance. Lallan is bound by the offer. The ratification by the company relates back to the time Badal accepted the offer, thus rendering the revocation of the offer inoperative. An offer once accepted cannot be withdrawn.

However, for the rule of relation back to apply, the agent while accepting an offer should not show lack of authority, e.g., where he accepts, 'subject to ratification', the rule of relation back does not apply and revocation shall be valid, if communicated prior to such ratification.

Express and Implied Ratification

The ratification may be express or implied.

Examples:

1. Amar without Puran's authority lends Puran's money to Kamal. Later Puran accepts interest on the money from Kamal. Puran's conduct implies ratification of the loan.
2. Amar without Puran's authority buys certain goods for him. Afterwards, Puran sells those goods to Kamal. Puran's conduct ratifies the purchase made by Amar.

Requisites of a Valid Ratification

To be valid, ratification must fulfill certain conditions. These conditions are:

1. The agent must contract as agent; he must not allow the third party to imagine that he is the principal. A person cannot enter into a contract at his own and later shift it to another.
2. The principal must have been in existence at the time the agent originally acted. This condition is significant in case of a company. The preliminary contracts entered into by promoters of a company on its behalf cannot be ratified by the company after incorporation because, if permitted, ratification will relate back to the point of time when promoters originally acted and at that time the company was not in existence. How can a person, not in existence, be a party to a contract?
3. The principal must not only be in existence but must also have contractual capacity at the time of the contract as well as at the time of ratification. Thus, a minor on whose behalf a contract is made cannot ratify it on attaining majority.
4. Ratification must be made within a reasonable time. What is a reasonable time shall vary from case to case?
5. The act to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is void *ab initio*.
6. The principal should have full knowledge of the facts (s.198).
7. Ratification must be of the contract as a whole. The principal cannot reject the burden and accept only the benefits.
8. Ratification of acts not within the principal's authority is ineffective. This again is basically relevant in case of companies. The acts of directors which are *ultra vires* the powers of a company cannot be ratified by the company.

Notes

9. Ratification cannot be made so as to subject a third party to damages or terminate any right or interest of a third person (s.200).

Examples:

1. Amar, not being authorised thereto by Bharat, demands on behalf of Bharat, the delivery of some property of Bharat, from Cooper, who is in possession of it. This demand cannot be ratified by Bharat, so as to make Cooper liable for damages for his refusal to deliver.
2. Amar holds a lease from Bharat terminable on three months notice. Cooper, an unauthorised person, gives notice of termination to Amar. The notice cannot be ratified by Bharat, so as to be binding on Amar.

9.2.7 Agency Coupled with Interest

Agency is said to be coupled with interest when authority is given for the purpose of securing some benefit to the agent. In other words, where the agent has himself an interest in the subject-matter of the agency, the agency is one coupled with interest.

Examples:

1. Agent is appointed to sell properties of the principal and to pay himself out of such sale proceeds the debt due to the agent. The authority of the agent is agency coupled with interest.
2. *A* consigns 100 bags of rice to *B*, who has made advances to him on such rice and desires *B* to sell the rice and to repay himself out of the price, the amount of his own advance. The authority of *B* is an authority coupled with interest.
3. *A* sells the goodwill and book debts of his business to *B* and appoints *B* as his agent to collect the debt.

It should be noted that, it is not the ordinary type of interest which every agent has such as the remuneration, but it is that special type of interest which agent possesses that makes it agency coupled with interest. In the case of agency coupled with interest, the agency cannot, unless there is an express contract, be terminated to the prejudice of such interest (s.202). It becomes irrevocable to the extent of such interest and does not terminate even by the insanity or death of the *principal*.

9.3 Classification of Agents

Agents may be classified from different points of view. One broad classification of agents is: (i) mercantile or commercial agents and (ii) non-mercantile or non-commercial agents. Another classification of agents is: (1) general and (2) special.

9.3.1 Special and General Agents

A special agent is a person appointed to do some particular act or enter into some particular contract. A special agent, therefore, has only a limited authority to do the specified act. If he does anything beyond the specified act, he runs the risk of being personally liable since the principal may not ratify the same. A general agent, on the other hand, is one who is appointed to represent the principal in all matters concerning a particular business, e.g., manager of a firm or managing director of a company.

Notes

9.3.2 Mercantile or Commercial Agents

A mercantile or commercial agent may assume any of the following forms: broker, factor, commission agent, del credere agent, auctioneer, banker, *Pakka and Katcha Adatias* and indentor. A broker is a mercantile agent engaged to buy and/or sell property or to make bargains and contracts between the engager and third party for a commission (called brokerage). A broker has no possession of goods or property. He is merely a connecting link between the engager and a third party. The usual method of dealing by a broker is to make entries of the terms of contract in a book, called the memorandum book and to sign them. He then sends the particulars of the same to both parties. The document sent to the seller is called the *sold note* and the one sent buyer is called the *bought note*. A factor is a mercantile agent who is entrusted with the possession of goods with an authority to sell the same. He can even sell the goods on credit and in his own name. He is also authorised to raise money on their security. A factor has a general lien on the goods in his possession. A factor, however, cannot barter the goods, unless expressly authorised to do. Also, he cannot delegate his authority.

A commission agent is agent who is employed to buy or sell goods or transact business. The remuneration that he gets for the purpose is called the commission. A commission agent is not liable in case the third party fails to carry out the agreed obligation. A commission agent may have possession of the goods or not. His lien in case of goods in his possession is a particular lien. A *del credere* agent is one who, in consideration of an extra remuneration, called a del credere commission, guarantees the performance of the contract by the other party. A *del credere* agent thus occupies the position of a guarantor, as well as of agent. He is normally appointed in case of deals with foreign nationals, about whom the principal may know nothing.

An auctioneer is agent appointed to sell goods by auction. He can deliver the goods only on receipt of the price. An auctioneer can recover the price from the highest bidder (i.e., the buyer) by filing a suit in his own name. In any case, an auctioneer can sell only by public auction and not by a private contract. His position differs from a factor inasmuch as the auctioneer has a particular lien, whereas the factor has a general lien.

Though the relationship between *banker* and customer is ordinarily that of debtor and creditor, he acts as his agent when he buys or sells securities on his behalf. Similarly, when he collects cheques, bills, interest, dividends, etc., or when he pays insurance premium out of customer's account, as per customer's mandate, he acts as his agent.

A Pakka adatia is a person who guarantees the performance of the contract, not only to his principal but also to the broker (shroff) on the other side. A peculiarity of pakka adatia is that he can himself perform the contract instead of offering it to the third party. A Katcha Adatia, on the other hand, does not guarantee the performance of the contract. However, he guarantees the performance on the part of the principal. Thus, he will be responsible to the other broker or shroff who contracts on behalf of the other party, in case of non-performance by his principal.

An indentor is a commission agent, who for a commission, procures a sale or a purchase on behalf of his principal, with a merchant in a foreign country. Such agent gets commission at the rates mentioned in the indent.

9.3.3 Non-mercantile or Non-commercial Agents

Some of the agents in this category are: wife, estate agent, counsels (advocates), attorneys. The following principles provide guidelines as regards *wife* as agent of her husband:

1. If the wife and husband are living together and the wife is looking for necessaries, she is agent. But this presumption may be rebutted and the husband may escape liability if he can prove that
    (a) he had expressly forbidden his wife from purchasing anything on credit or from borrowing money,

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(b) goods, purchased were not necessaries,

(c) he had given sufficient money to his wife for purchasing necessaries, or

(d) the trader had been expressly told not to give credit to his wife.

2. Where the wife lives apart from the husband, through no fault of hers, the husband is liable to provide for her maintenance. If he does not provide further maintenance, she has an implied authority to bind the husband for necessaries, i.e., he would be bound to pay her bills for necessaries. But where the wife lives apart under no justifiable circumstances, she is not her husband's agent and thus cannot bind him even for necessaries.

9.3.4 Sub-agent and Substituted Agent

The general rule is that agent cannot appoint agent. The governing rule is enshrined in a maxim 'a delegate cannot further delegate'. Agent being a delegate cannot transfer his duties to another. The principle underlying the rule is that the principal engages agent ordinarily on personal consideration and thus may not have the same confidence in the person appointed by the agent. Hence, sub-agency is not generally recognised. However, deals with the circumstances as to when and how far agent can delegate his duties. Agent may appoint agent in the following circumstances:

1. where expressly permitted by the principal;
2. where the ordinary custom of the trade permits delegation;
3. the nature of agency is such that it cannot be accomplished without the appointment of a sub-agent;
4. where the nature of the job assigned to the agent is purely clerical and does not involve the exercise of discretion, e.g., if Anthony is appointed to type certain papers, because of lack of time, he assigns the job to another equally competent typist Bharat, the delegation is valid;
5. in an unforeseen emergency.

Under the above-mentioned circumstances stipulated by s.190, if agent appoints another person in the matter of the agency, that other person may assume the position of either a sub-agent or a substituted agent. Section 191 states that a sub-agent is a person employed by and acting under the control of the original agent in the business of agency. Since the sub-agent is appointed by the act and under the control of the agent, there is no privity of contract between the sub-agent and the principal. The sub-agent, therefore, cannot sue the principal for remuneration and, similarly the principal cannot sue the sub-agent for any moneys due from him. Each of them can proceed against his immediate contracting party, viz, the agent except where the sub-agent is guilty of fraud. In that case, the principal has a concurrent right to proceed against the agent and the sub-agent. A sub-agent properly appointed, however, can represent the principal and bind him for his acts as if he were agent originally appointed by the principal. But where agent, without having the authority to do so, has appointed a sub-agent, the principal is not represented by or responsible for the acts of such a sub-agent. The sub-agent can only bind the agent by contracts entered into with third parties.

Where agent appoints or names another person for being appointed as agent in his place, such person is called a *substituted agent* (s.194).

Examples:

1. Amar directs Bharat, his solicitor, to sell his estate by auction and to employ an auctioneer for the purpose. Bharat names Cooper, an auctioneer, to conduct the sale. Cooper is not a sub-agent, but is Amar's agent for the conduct of the sale.

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2. Amar authorises Bharat, a merchant in Calcutta, to recover the money due to Amar from Cooper and Co. Bharat instructs Dalip, a solicitor to take proceedings against Cooper and Co. for the recovery of the money. Dalip is not a sub-agent but is a solicitor for Amar.

9.4 Duties and Rights of Agent

9.4.1 Duties of Agent

The duties of agent towards his principal are:

1. ***To conduct the business of agency according to the principal's directions (s.211):*** The duty of the agent must be literally complied with, i.e., the agent is not supposed to deviate from the directions of the principal even for the principal's benefit. If he does so, any loss occasioned thereby shall have to be borne by the agent, whereas any surplus must be accounted for to the principal.

Examples:

(i) Anil is directed by his principal to warehouse the goods at a particular warehouse. He warehouses a portion of the goods at another place, equally good but cheaper. The goods are destroyed by fire. Anil, the agent, is liable to make good the loss.

(ii) A principal instructs his agent to deliver goods only against cash but the agent delivers them on credit. In such a case, the agent would be liable for the price which the purchaser fails to pay.

In the absence of instructions from the principal, however, the agent should follow the custom of the business at the place where it is conducted.

Example: Amar, agent, engaged in carrying on for Bharat a business in which it is the custom to invest from time to time, at interest, the money which may be in hand, omits to make such investment. Amar must make good to Bharat the interest usually obtained by such investment.

2. ***The agent should conduct the business with the skill and diligence*** that is generally possessed by persons engaged in similar business, except where the principal knows that the agent is wanting in skill (s.212).

Examples:

(i) Where a lawyer proceeds under a wrong section of law and thereby the case is lost, he shall be liable to his client for the loss.

(ii) Amar, agent for the sale of goods, having authority to sell on credit, sells to Bhagat on credit, without making the proper and usual enquiries as to the solvency of Bhagat. Bhagat, at the time of such sale, is insolvent. Amar has to compensate his principal in respect of any loss thereby sustained.

(iii) Amar, an insurance broker, employed by Bharat to effect an insurance on a ship, omits to see that whether the usual clauses are inserted in the policy. The ship is afterwards lost. In consequence of the omission of the clauses nothing can be recovered from the underwriters. Bharat is bound to make good the loss to Amar.

3. ***To render proper accounts (s.213):*** The agent has to render proper accounts. If the agent fails to keep proper accounts of the principal's business, everything consistent with the proved facts will be presumed against him. Rendering of accounts does not mean showing the accounts, but maintaining proper accounts supported by vouchers.

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4. ***To communicate with the principal in case of difficulty (s.214):*** It is the duty of agent, in case of difficulty, to use all reasonable diligence, in communicating with his principal and in seeking to obtain his instructions. In case of emergency, however, the agent can do all that a reasonable man would, under similar circumstances, do with regard to his own business. He becomes agent by necessity.

5. ***Not to make any secret profits:*** Agent should deliver to the principal all moneys including secret commission received by him. He can, however, deduct his lawful expenses and remuneration.

6. ***Not to deal on his own account:*** Agent should not deal on his own account without first obtaining the consent of his principal. If he does so, the principal can claim from the agent any benefit which he might have obtained.

Example: Pawan directs Amar, his agent, to buy a particular house for him. Amar tells Pawan that it cannot be bought, but buys the house for himself. Pawan may, on discovering that Amar has bought the house, compel him to sell it to Pawan at the price he bought.

Further, in case agent deals on his own account, he shall cease to be entitled for his remuneration as agent.

7. ***Not entitled to remuneration for misconduct:*** Agent who is guilty of misconduct in the business of agency is not entitled to any remuneration in respect of that part of the business which he has misconducted.

Examples:

(i) Amar employs Bharat to recover ₹ 50,000 from Cooper and to lay it out on a good security. Bharat recovers the amount and lays out ₹ 30,000 on good security, but lays out ₹ 20,000 on security which he ought to have known to be bad whereby Amar loses ₹ 5,000. Bharat is entitled to remuneration for recovering ₹ 50,000; and for investing ₹ 30,000. He is not entitled to any remuneration for investing ₹ 20,000 and he must make good the ₹ 5,000 to Amar.

(ii) Amar employs Bharat to recover ₹ 10,000 from Cooper. Through Bharat's misconduct the money is not recovered. Bharat is not entitled to any remuneration for his services and must make good the loss.

8. ***Not to disclose confidential information supplied*** to him by the principal.

9. ***To take all reasonable steps for the protection and preservation of the interests entrusted to him*** when the principal dies or becomes of unsound mind (s.209).

9.4.2 Rights of Agent

Agent has a number of rights. These are:

1. ***Right to remuneration (Ss. 219-220):*** Agent is entitled to his agreed commission or remuneration and if there is no agreement, to a reasonable remuneration. But the remuneration does not become payable unless he has carried out the object of agency, except where there is a contract to the contrary. When the object of agency is deemed to have been carried out or the act assigned to the agent is completed would depend on the terms of the contract. Further, the transaction for which the agent claims remuneration should be the direct result of his services.

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Example: Pawar appoints Amar, a broker. Amar is entitled to his commission when he has procured a party who is willing to negotiate on reasonable terms and to desirous of entering into a contract with Pawar.

Agent, however, is not entitled to any remuneration in respect of that part of the business which he has misconducted (s.220).

2. ***Right of retainer (S.217):*** Agent may retain, out of any sums received on account of the principal in the business of the agency, all moneys due to himself in respect of advances made or expenses properly incurred by him in conducting such business and also such remuneration as may be payable to him for acting as agent. This is known as agent's right of retainer. However, the right of retainer can only be claimed on moneys received by him in the business of agency. He cannot, therefore, retain sums received by him in one business for his commission or remuneration in an other business on behalf of the same principal.

3. ***Right of lien (S.221).*** In the absence of any contract to the contrary, agent is entitled to retain goods, papers and other property, whether movable or immovable of the principal received by him, until the amount due to himself for commission, disbursements and services in respect of the same has been paid or accounted for to him. This lien of the agent is a particular lien confined to all claims arising in respect of the particular goods and property. By a special contract, however, agent may get a general lien extending to all claims arising out of the agency. Since, the word 'lien' means retaining possession; it can be enjoyed by the agent only where the goods or papers are in actual or constructive possession of the agent. The right of lien will, therefore, be lost where he parts with the possession of goods or papers. But if the possession is obtained from the agent by fraud or unlawful means, his lien is not affected by the loss of possession.

4. ***Right of stoppage in transit:*** The agent can stop the goods while in transit in two cases: (a) where he has purchased goods on behalf of the principal either with his own funds, or by incurring a personal liability for the price, he stands towards the principal in the position of an unpaid seller. Like an unpaid seller, he enjoys the right of stopping the goods in transit if in the meantime the principal has become insolvent. (b) Where agent holds himself liable to his principal for the price of the goods sold, for example, *del credere agent,* he may exercise the unpaid seller's right of stopping the goods in transit in case of buyer's insolvency.

5. ***Right of indemnification (Ss. 222-224):*** The principal is bound to indemnify agent against the consequences of all lawful acts done by the agent in exercise of authority conferred on him.

Examples:

(i) John, at Singapore, under instructions from Amin at Calcutta, contracts with Cooper to deliver certain goods to him. Amin does not send the goods to John and Cooper sues John for breach of contract. John informs Amin of the suit and Amin authorizes him to defend the suit. John defends the suit and is compelled to pay damages and costs and incurs expenses. Amin is liable to John for such damages, cost and expenses.

(ii) Bharat, a broker at Calcutta, by the order of Amin, a merchant there, contracts with Cooper for the purchase of 10 casks of oil for Amin. Afterwards Amin refuses to receive the oil and Bharat sues Cooper. Bharat informs Amin, who repudiates the contract altogether. Bharat defends, but unsuccessfully and has to pay damages and costs and incur expenses. Amin would be liable to Bharat for such damages, costs and expenses.

Section 223 further provides that agent shall have a right to be indemnified against consequences of acts done in good faith.

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Example: B, at the request of A, sells goods in the possession of A, but which A had no right to dispose of. B does not know this and hands over the proceeds of the sale to A. Afterwards C, the true owner of goods, sues B and recovers the value of the goods and costs. A is liable to indemnify B for what he has been compelled to pay to C and for B's own expenses, provided C has acted in good faith and he had no knowledge that the goods did not belong to A.

However, it must be remembered that agent cannot claim indemnification for criminal act, even though the principal had agreed to do so (s.224).

Examples:

(i) A employs B to beat C and agrees to indemnify him against all consequences of that act. B thereupon beats C and has to pay damages to C for so doing. A is not liable to indemnify B for those damages.

(ii) B, the proprietor of a newspaper, publishes, at A's request, a libel (defamation in writing) upon C in the paper and A agrees to indemnify B against the consequences of the publication and all costs and damages of any action in respect thereof. B is sued by C and has to pay damages and also incurs expenses. A is not liable to B on the indemnity.

6. ***Right to compensation for injury caused by principal's neglect (s.225):*** The principal must make compensation to his agent in respect of injury caused to such agent by the principal's neglect or want of skill.

Example: A employs B as a bricklayer in building a house and puts up the scaffolding himself. The scaffolding is unskillfully put up and B is in consequences hurt. A must make compensation to B.

Task Analyze the role and rights of agents in real estate sector.

9.5 Principal's Duties to the Agent and his Liability to Third Parties

9.5.1 Duties of a Principal

The rights of agent are in fact the duties of the principal. Thus a principal is (i) bound to indemnify the agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him (ii) liable to indemnify agent against the consequences of an act done in good faith, though it causes an injury to the rights of third persons (iii) bound to compensate his agent in respect of injury caused to such agent by the principal's neglect or want of skill (s.225).

The principal is, however, not liable for acts which are criminal in nature though done by the agent at the instance of the principal (s.224).

9.5.2 Liability of Principal to Third Parties

Liabilities of a principal to third parties are given below:

1. Agent being a mere connecting link binds the principal for all his acts done within the scope of his authority.

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Example: A, being B's agent with authority to receive money on his behalf, receives from C a sum of money due to B. C is discharged of his obligation to pay the sum in question to B.

2. The principal is liable for the acts of the agent falling not only within the actual authority but also within the scope of his apparent or ostensible authority.

3. Where agent exceeds his authority and the part of what he does, which is within his authority, can be separated from the part which is beyond his authority, so much only of what he does as is within his authority, is binding as between him and the principal.

Example: A, being the owner of a ship and cargo, authorizes B to procure an insurance for ₹ 4,000 on the ship. B procures a policy of ₹ 4,000 on the ship and another for the like sum on the cargo. A is bound to pay the premium for the policy on the ship, but not the premium for the policy on the cargo.

However, where agent does more than he is authorized to do and what he does beyond the scope of his authority cannot be separated from what is within it, the principal is not bound by the transaction (s.228).

Example: Agent is authorized to draw a bill for ₹ 5,000 but he draws a bill for ₹ 10,000, the principal will not be liable even to the extent of ₹ 5,000.

4. The principal will be liable even for misrepresentations made or frauds committed by agent in the business of agency for his own benefit. But misrepresentations made or frauds committed by agents in matters beyond their authority do not affect their principals (s.238).

Examples:

(i) A, being B's agent for the sale of goods, induces C to buy them by a misrepresentation, which he was not authorized by B to make. The contract is voidable, as between B and C, at the option of C.

(ii) A, the captain of B's ship, signs bills of lading without having received on board the goods mentioned therein. The bills of lading are void as between B and the pretended consignor.

5. The principal remains liable to the third parties even where his name was not disclosed. The third parties, on discovering his name, can proceed against him on the contract.

6. The principal is bound by any notice or information given to the agent in the course of business transacted by him.

7. The liability of the principal continues even in cases where agent is held personally liable. Section 223 provides an option to the third parties to either sue the principal or agent or both.

9.5.3 Undisclosed Principal

Where agent, though discloses the fact that he is agent working for some principal, conceals the name of the principal, such a principal is called an undisclosed principal. The liability of an undisclosed principal is similar to that of a disclosed principal unless there is a trade custom making the agent liable. However, the undisclosed principal must exist and must also be the principal at the time the contract is made. He cannot be brought into existence as a principal after the contract has been concluded.

9.5.4 Concealed Principal

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Where agent conceals not only the name of the principal but the very fact that there is a principal, the principal is called a concealed principal. In such a case, the third parties are not aware of the existence of the principal and regard the agent as the person contracting for himself. The third parties, thus, must look to the agent for payment or performance and the agent may sue or be sued on the contract. Legal position in this regard is as follows:

1. If the principal wishes to intervene, he may require the performance of the contract, but the other party has, as against him (principal), the same rights as he would have had as against the agent if the agent has been principal.
2. Para II of s. 231 provides that in such a case, if the principal discloses himself before the contract is completed the other contracting party may refuse to fulfill the contract, if he can show that if he had known who was the principal in the contract, or if he had known that the agent was not the principal, he would not have entered into the contract.
3. If the principal requires performance of the contract, he can only obtain such performance subject to the rights and obligations subsisting between the agent and the other party to the contract.

Example: 'A' who owes ₹ 500 to B, sells 1,000 rupees worth of rice to B. A is acting as agent for C in the transaction, but B has neither knowledge nor reasonable ground of suspicion that such is the case. C cannot compel B to take the rice without allowing him to set off A's debt.

4. In contracts with a concealed principal, the agent is, in the absence of a contract to the contrary, personally liable to the third party. The party may hold either the agent or principal or both liable (s.223).

Example: A enters into a contract with B to sell him 100 bales of cotton and afterwards discovers that B was acting as agent for C. A may sue either B or C, or both for the price of the cotton.

9.6 Personal Liability of Agent

Agent is only a connecting link between the principal and third parties. Being only a medium, he can, in the absence of a contract to the contrary, neither personally enforces contracts entered into by him on behalf of his principal, nor is he personally bound by them.

From the above discussion, it may be inferred that agent can enforce contracts personally and be held bound for contracts entered into on behalf of his principal, if there is an agreement to the effect, express or implied.

Section 230 enlists the following cases where a contract to this effect shall be presumed to exist:

1. Where the contract is made by agent for the sale or purchase of goods for a merchant resident abroad
2. Where the agent does not disclose the name of his principal
3. Where the principal, though disclosed, cannot be sued, for instance, where principal is a minor.

Besides, agent incurs a personal liability in the following cases:

1. ***Breach of warranty:*** Where agent acts either without any authority or exceeds his authority, he is deemed to have committed breach of warranty of authority in such a case. He will be held personally liable if his acts are not ratified by the alleged principal. Further, agent

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will be guilty of warranty of authority even where his authority is terminated without his knowledge, e.g., by death or lunacy of the principal.

2. ***Where the agent expressly agrees to be personally bound:*** This sort of stipulation may be provided particularly where principal does not enjoy much credit-worthiness and the third parties wish to ensure the payment or performance.

3. ***Where agent signs a negotiable instrument in his own name:*** In case agent signs a negotiable instrument without making it clear that he is signing it as agent only, he may be held personally liable on the same. He would be personally liable as the maker of the note, even though he may be described in the body of the note as the agent (s.28, Negotiable Instrument Act, 1881).

4. Agent with special interest or with a beneficial interest, e.g., a factor or auctioneer, can sue and be sued personally.

5. When agent is guilty of fraud or misrepresentation in matters which do not fall within his authority (s.238).

6. Where trade usage or custom makes agent personally liable.

7. Where the agency is one coupled with interest.

Task "A" consigned goods by Railways. The consignment, at the time of delivery, was found damaged. After obtaining a certificate of damages from the Railway Officer, A claimed from the Railways compensation of ₹ 2,300. The general Manager of the Railways sent him a cheque for ₹ 1,300 in full and final settlement. The cheque was encashed, but after a lapse of sometime. A claimed that the payment had satisfied only a part of his claim and demanded payment of the balance. Discuss the claim of A for payment of the balance amount.

9.7 Termination of Agency

An agent's authority can be terminated any time. It is terminated by insanity of either party by bankruptcy and by the destruction of subject matter.

9.7.1 Circumstances under which Agency Terminates or Comes to an End

Agency may be terminate by the principle and agent such as: (1) On revocation by the principal, (2) On the expiry of fixed period of time, (3) On the performance of the specific purpose, (4) Insanity or death of the principal or agent, (5) Insolvency of the principal, (6) By renunciation of agency by the agent.

1. ***On revocation by the principal:*** The principal may, by notice, revoke the authority of the agent at any time. Where the agent is appointed to do a single act, agency may be revoked any time before the commencement of the act. In case of a continuous agency, notice of revocation is essential to the agent as well as to the third parties who have acted on the agency with the knowledge of the principal.

   Where agency is for a fixed period of time and the contract of agency is revoked without sufficient cause, compensation must be paid to the agent (s.205).However, the agency is irrevocable in two cases: (i) Where the authority of the agent is one coupled with interest; *i.e.,* the agent has an interest in the subject-matter of the contract. The principal cannot revoke the authority given to his agent after the authority has been partly exercised so far as regards such acts and obligations already done in the agency (s.204).

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Examples:

(i) A gives authority to B to sell A's land and to pay himself out of the proceeds, the debts due to him from A. A cannot revoke this authority, nor can it be terminated by his insanity or death.

(ii) A authorizes B to buy 1,000 bales of cotton on account of A and to pay for it out of A's money remaining in B's hands. B buys 1,000 bales of cotton in his own name, so as to make himself personally liable for the price. A cannot revoke B's authority to pay for the cotton.

(iii) A authorizes B to buy 1,000 bags of rice on account of A and to pay for it out of A's money remaining in B''s hands. B buys 1,000 bags of rice in A's name, so as not to make himself personally liable for the price. A can revoke B's authority to pay for the rice.

2. ***On the expiry of fixed period of time:*** When the agency is for a fixed period of time, it comes to an end on the expiry of that time.

3. ***On the performance of the specific purpose:*** Where agent is appointed to do a particular act, agency terminates when that act is done or when the performance becomes impossible.

4. ***Insanity or death of the principal or agent:*** Death or insanity of the principal or the agent terminates the agency. But, agent, in such a case, should take all reasonable steps for the preservation of property, on behalf of the legal representatives of the principal (s.209).

5. An agency shall also terminate in case the ***subject matter is either destroyed or rendered unlawful***.

6. ***Insolvency of the principal:*** Insolvency of the principal, not of the agent, terminates the agency.

7. ***By renunciation of agency by the agent:*** If principal can cause termination of agency by revocation, agent may renounce his agency by giving a sufficient notice to that effect. Where, however, agency is for a fixed period and the agency is renounced without a sufficient cause, the principal must be compensated (s.205).

9.7.2 When Termination of Agency takes Effect?

1. The termination of the authority of agent does not, so far as regard the agent, takes effect before it becomes known to him (s.208).

2. As regards third parties, they can continue to deal with the agent till they come to know of the termination of the authority (s.208).

Examples:

(i) A directs B to sell goods for him and agrees to give B 5% commission on the price fetched by the goods. A afterwards, by a letter revokes B's authority. B, after the letter is sent, but before he receives it, sells the goods for ₹ 100. The sale is binding on A and B is entitled to five rupees as his commission.

(ii) A, at Chennai, by a letter directs B to sell for him some cotton lying in a warehouse in Mumbai and afterwards, by another letter, revokes his authority to sell and directs B to send the cotton to Chennai. B, after receiving the second letter, enters into a contract with C, who knows of the first letter, but not of the second. For the sale to him of the cotton C pays B the money, with which B absconds. C's payment is good as against A.

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(iii) A directs B, his agent, to pay certain money to C. A dies and D takes out probate to his will. B, after A's death, but before hearing of it, pays the money to C. The payment is good as against D, the executor.

3. The termination of the authority of agent causes the termination of authority of all sub-agents appointed by him.

9.8 Powers of Attorney

A power of attorney is defined by Sec.2(21) of the Stamp Act, as including "any instrument not chargeable with a fee under the law relating to court fees for the time being in force," which empowers "a specified person to act for and in the name of the person executing it". It is the Powers of Attorney Act, 1882, which deals with the subject, but does not define it. In common parlance, a power of attorney is an instrument or a deed by which a person is empowered to act for and in the name of the person executing it. The person executing the deed is known as the Principal or donor and the one in whose favour it is executed is the agent, or the power agent or the power of attorney agent.

9.8.1 A Power of Attorney may be Special or General

If the deed conferring power by one to another relates to one single transaction, it is known as special power of attorney. If the deed conferring power relates to several transactions it is general power of attorney.

9.8.2 Registration

As a general rule, registration of power of attorney is not necessary but if it authorises the donee to recover the rents of an immovable property of the donor for the donee's benefit, it would require registration. And so also a power creating a charge in favour of the donee upon an immovable property referred to therein.

Further Sec.32 (c) of the Registration Act, 1908, requires that where a document is presented for registration by the agent of a person entitled to present it for registration, such agent must be duly authorised by power of attorney executed and authenticated in manner as mentioned in Sec.33 of the Act.

Such a power of attorney is to be executed before and authenticated by a registrar or sub-registrar. Unregistered power executed in a foreign country before a notary public can be used by the agent for presentation of document for registration. The power of attorney, however, executed before a notary public in India will not enable the agent to present any document for registration under the Registration Act, 1908.

The power of attorney is required to be engrossed on non-judicial stamp paper. The amount of stamp duty varies with different types of powers as described in the Stamp Act and varies among different States of India. Sec.4 of the Power of Attorney Act, 1882 provides that the original deed of power can be deposited in the High Court in whose jurisdiction the principal resides and a certified copy of the deed can be obtained from the High Court. Such certified copies are equal to originals and are binding on all.

Task P employs A as his agent to sell 100 bags of sugar and directs him to sell at a price not less than ₹ 120 per bag. A sells the entire quantity at ₹ 110 per bag whereas the market rate on the date of sale was ₹ 115 per bag. Is P entitled to any damages and if so, at what rate?

Notes

Case Study

Financial Planning in Insurance

Over the years, it has been almost a standard practice for the agents of Life Insurance Corporation to give their customers a part of their commission. They usually paid the first quarter's premium on behalf of the customer. That this practice is illegal, is a fact, and therefore not a matter of opinion. However, there are two views over whether the law should prohibit this `rebating', or not.

Most life insurance companies support banning of rebating, although they all agree that monitoring this is almost impossible. "There has to be a change in awareness level for all customers to refrain from rebating," says Ms Suniti Ghoshal, Head-Corporate Communications, Aviva Life Insurance (formerly, Dabur CGU Life Insurance).

"This industry has been with a monopoly player, hence certain things have only been done without being questioned much," Ms Ghoshal said, in an e-mail to Business Line.

Other insurance companies agree. "An agent rebates in order to shorten his sales cycle. This shortening of process often leads to misrepresentation resulting in poor service quality," says a spokesman of Max New York Life Insurance. However, another point of view of the same issue is that there is no point in prohibiting rebating by agents, which is any way extremely difficult to monitor. Advocates of this view point out that in most countries; insurance companies are even allowed to extend credit to their customers for premiums. In India, a claim is payable if and only if the premium has been received in full. Rebating is in a way an informal credit extended to the customer by the agent.

After all, the agent is paying out of his pocket. Why prohibit rebating only in the insurance industry, when discount is a way of life in all other industries?

But insurance companies do not like it. Mr Dilip Gazaaro, Head-Retail Sales, HDFC Standard Life, says that his company actually dismissed an agent for rebating.

At Aviva, the Financial Planning Advisers are trained to handle such demands, says Ms Ghosal. "They can explain the customer as to why he needs to pay the agent for his service. If the customer can pay substantial amounts for premium, he also needs to ensure that the advice he receives and the service he avails of for his policy are the best in terms of quality and integrity." Max New York Life's spokesman echoes similar views. "We as an industry are also establishing a code of conduct against such practices. At the Life Insurance Executive Council, we have recommended that the penalty for rebating be increased from ₹ 500 to ₹ 10,000." There are others who believe that rebating should continue to be illegal, no matter how difficult it is to monitor. Says Mr N. Raveendran, Director, Alegion Risk Management Services (which proposes to become a general insurance broker), "Legalising rebating would drive away the serious agents who do not usually give rebates". He says that there would come a time, when the society matures enough to be willing to pay for a service, that rebating will automatically go away.

After all, you don't necessarily go to the doctor who charges the least. But legalising rebating would push back the arrival of such a time.

Question

Discuss the financial planning advisor role in insurance industry. (***Hint:*** Basically financial advisor is a main person who involve more and more in the planning of insurance sector.

Notes

9.9 Summary

- In this unit you studied about law of agency. Agent is "a person employed to do any act for another or to represent another in dealings with third person".
- Thus, agent is a person who acts in place of another. The person for whom or on whose behalf he acts is called the Principal.
- Contract of agency may be created by an express agreement or by implication (implied agreement) or by ratification.
- Thus, there are different kinds of agency. Implied agency arises from the conduct, situation or relationship of parties.
- Implied agency, therefore, includes agency by estoppel, agency by holding out and agency of necessity.
- The principal may, by notice, revoke the authority of the agent at any time. Where the agent is appointed to do a single act, agency may be revoked any time before the commencement of the act. In case of a continuous agency, notice of revocation is essential to the agent as well as to the third parties who have acted on the agency with the knowledge of the principal.
- Where agent is appointed to do a particular act, agency terminates when that act is done or when the performance becomes impossible.
- Insolvency of the principal, not of the agent, terminates the agency.
- The termination of the authority of agent does not, so far as regard the agent, takes effect before it becomes known to him.
- A power of attorney is defined by Sec.2(21) of the Stamp Act, as including "any instrument not chargeable with a fee under the law relating to court fees for the time being in force," which empowers "a specified person to act for and in the name of the person executing it".

9.10 Keywords

Agency by Estoppel: Agency by estoppel arises where a person by his words or conduct third persons to believe that a certain person is his agent.

Agency by Express Agreement: An agency by express agreement is created when by spoken or written words an express authority is given to an agent.

Agent: A person employed to do any act for another or to represent another in dealings with third person.

Auctioneer: An agent appointed to sell goods by auction.

Implied agency: It arises from the conduct, situation or relationship of parties.

Special agent: A person appointed to do some particular act or enter into some particular contract.

Sub-agent: A sub-agent is a person employed by and acting under the control of the original agent in the business of the agency.

Notes

9.11 Self Assessment

State whether the following statements are true or false:

1. A substituted agent is as good agent of the agent as a sub-agent.
2. An ostensible agency is as effective as an express agency.
3. Ratification tantamount to prior authority
4. Agent being merely a connecting link is never personally liable.
5. An agency coupled with interest is irrevocable.

Fill in the blanks:

6. The principal is not liable for …… acts done by the agent at the instance of the principal.
7. The liability of an undisclosed principal is similar to that of a disclosed principal unless there is a …… making the agent liable.
8. A …… is a mercantile agent engaged to buy and/or sell property.
9. The person executing the deed is known as the …….
10. The power of attorney is required to be engrossed on …….

9.12 Review Questions

1. How is agency created?
2. What is 'agency by estoppel'? In what way does it differ from agency by holding out?
3. Explain clearly the meaning of 'agency by ratification'. What conditions must be fulfilled for a valid ratification? Explain the effects of a valid ratification.
4. Discuss the extent to which agent can delegate his authority. State the consequences where the agent properly employs a sale agent and when he appoints him without authority.
5. Discuss the rights of agent against his principal.
6. In what ways may a contract of agency be terminated by the act of the parties?
7. Describe the meaning of 'agency by ratification'. What conditions must be fulfilled for a valid ratification? Explain the effect of a valid ratification.
8. "Agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act." Comment.
9. What do you mean by del credere agent?

Answers: Self Assessment

1.	False	2.	True
3.	True	4.	False
5.	True	6.	criminal
7.	trade custom	8.	broker
9.	Principal or donor	10.	Non-judicial stamp paper

Notes

9.13 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://alialawagency.com/

http://www.labourlawagency.com/

http://www.dateyvs.com/gener03.html

Unit 10: Law of Partnership Act

Notes

CONTENTS

Objectives

After studying this unit, you will be able to:

- State the meaning of partnership, partnership deed and types of partnership
- Explain distinction between partnership firm and co-ownership
- Discuss implied authority and third parties and implied authority
- Describe overview of the Limited Liability Partnership Act, 2008

Notes

Introduction

In the earlier units, you came to know about the contract of agency. In this unit you will study about the law of partnership. An individual or a group of persons may decide to start business. One of the first steps to be taken is to determine what kind of business organisation it will be. If only one person starts the business, we call that business sole proprietorship and if a group of persons start the business that can be either partnership business, or a company or a cooperative form of organisation. This unit begins by defining a sole proprietorship. The essential features of this form of organisation are enumerated.

10.1 Meaning and Nature of Partnership

A partnership is defined as "the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all". On analysis of the definition, certain essential elements of partnership emerge. These elements must be present so as to form a partnership and are discussed below.

1. ***Partnership is an association of two or more than two persons.*** There must be at least two persons who should join together to constitute a partnership, because one person cannot become a partner with himself. These persons must be natural persons having legal capacity to contract. Thus, a company (which is an artificial person) cannot be a partner. Similarly, a partnership firm cannot be a partner of another partnership firm. As regards maximum number of partners in a partnership firm, Sec.11 of the Companies Act, 1956, puts the limit at 10 in case of banking business and 20 in case of any other business.
2. ***Partnership must be the result of an agreement between two or more persons.*** An agreement presupposes a minimum number of two persons. As mentioned above, a partnership to arise, at least two persons must make an agreement. Partnership is the result of an agreement between two or more persons (who are known as partners after the partnership comes into existence).
3. ***The agreement must be to carry on some business.*** The term 'business' includes every trade, occupation or profession [Sec.2(b)]. Though the word 'business' generally conveys the idea of numerous transactions, a person may become a partner with another even in a particular adventure or undertaking (Sec.8). Unless the person joins for the purpose of carrying on a business, it will not amount to partnership.
4. ***The agreement must be to share profits of the business.*** The joint carrying on of a business alone is not enough; there must be an agreement to share profits arising from the business. Unless otherwise so agreed, sharing of profits also involves sharing of losses. But whereas the sharing of profits is an essential element of partnership, sharing of losses is not.

Example: A, a trader, owed money to several creditors. He agreed to pay his creditors out of the profits of his business (run under the creditors' supervision) what he owed to them. Held, the arrangement did not make creditors partners with A in business [*Cox v. Hickman*, (1860) 8 H.L.C., 268].

10.1.1 Formation of Partnerships

All the essential elements of a valid contract must be present in a partnership as it is based on an agreement. Therefore, while constituting a partnership. The following points must be kept in mind:

1. The Act provides that a minor may be admitted to be benefits of partnership.

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2. No consideration is required to create partnership. A partnership is an extension of agency for which no consideration is necessary.
3. The partnership agreement may be express (i.e., oral or writing) or implied and the latter may be inferred from the conduct or the course of dealings of the parties or from the circumstances of the case. However, it is always advisable to have the partnership agreement in writing.
4. An alien friend can enter into partnership, an alien enemy cannot.
5. A person of unsound mind is not competent to enter into a partnership.
6. A company, incorporated under the Companies Act, 1956 can enter into a contract of partnership.

10.1.2 Duration of Partnership

The duration of partnership may or may not be fixed. It may be constituted even for a particular adventure.

10.1.3 Partnership at Will

In accordance with Sec. 7, a partnership is called a partnership at will where; (i) it is not constituted for a fixed period of time and (ii) there is no provision made as to the determination of partnership in any other way. Therefore such a partnership has no fixed or definite date of termination. Accordingly death or retirement of a partner does not affect the continuance of such a partnership.

10.1.4 Particular Partnership

In accordance with Sec. 8 a particular partnership is one which is formed for a particular adventure or a particular undertaking. Such a partnership is usually dissolved on the completion of the adventure or undertaking.

10.1.5 Limited Partnership

In this type of partnership, the liability of certain partners is limited to the amount of capital which they have agreed to contribute to the business. In a limited partnership, there will be at least one general partner whose liability is unlimited and one or more special partners whose liability is limited.

10.2 Registration of Firms (Secs.58-59)

10.2.1 Application for Registration

Sec.58 lays down the procedure for registration of partnership firms. A partnership firm may be registered at any time by post, or delivering to the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating: (i) the firm's name, (ii) the place or the principal place of business of the firm, (iii) the names of any other places where the firm carries on business, (iv) the date when each partner joined the firm, (v) the names in full and addresses of the partners and (vi) the duration of the firm. The statement must be signed by all the partners, or by their agents especially authorised in that behalf and duly verified. When the Registrar of Firms is satisfied that the provisions of Sec.58 have been duly complied with, he registers the

Notes

firm by recording an entry of the statement in a register called the Register of Firms and shall file the statement (Sec.59). He then issues under his hand a Certificate of registration. Registration is effective from the date when the Registrar files the statement and makes entries in the Register of Firms.

10.2.2 Registration of Firms is Optional

The Act does not provide for compulsory registration of firms. It is optional and there is no penalty for non-registration. But at the same time Sec.69 has effectively, ensured registration of firms by introducing certain disabilities that an unregistered firm suffers from. The firm cannot.

10.3 Partnership Deed

10.3.1 A Partnership can be Formed either by Oral or Written Agreement

In France and Italy, the law requires all partnership agreements to be in writing. But in England, USA and India, written agreement is not compulsory. But in order to avoid misunderstanding and litigation, it is desirable to enter into a written agreement which is called Partnership deed or agreement. The partnership deed is required to be stamped according to the provisions of the Stamp Act, 1899. Each partner should possess a copy of the Deed.

10.3.2 Partnership Agreements and Contract Law

Sec.3 provides that the unrepealed provisions of the Indian Contract Act, 1872 save insofar as they are inconsistent with the provisions of this Act, shall continue to apply to firms. Also Sec.2(e) provides that "expressions used but not defined in this Act and defined in the Indian Contract Act, 1872, shall have the meanings assigned to them in that Act". As a partnership agreement is a contract, the provisions of the Indian Contract Act, 1872, are applicable to it.

Task A publisher agreed to publish, at his own expense, a book written by B and to share the profits equally. B wanted to terminate the partnership by notice after publication of tenth edition of the book. Can he do so?

10.4 Relations of Partners to One Another

The relation of the partners of a firm to one another arises through an agreement between them. Such an agreement may be express or may be implied from the course of dealings between them. It may be varied by their consent and such consent may be expressed or may be implied by a course of dealings [Sec.11 (1)]. Where there is no specific agreement or where the agreement is silent at a certain point, or where no agreement exists, the relations of partners to one another as regard their rights and duties are governed by Secs.9-17 of the Act.

10.4.1 Rights of Partners

Subject to the contract between the partners, every partner has the following rights:

1. To take part in the conduct of the firm's business [Sec.12(a)].
2. To express his opinion on any matter, but in case of difference of opinion regarding ordinary matters of the business, he is bound by the majority decision. However, no change can be made in the nature of the business without the consent of all the partners [Sec.12(c)].

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3. To have access to and inspect and copy any of the books of the firm [Sec.12(d)].
4. To share equally in the profits [Sec.13(b)].
5. To rank as a joint owner of the property of the firm.
6. To do, in an emergency, all such acts as are reasonably necessary to protect the firm from loss.
7. To claim interest @ 6 per cent per annum on any amount advanced by him beyond the amount of capital that he agreed to subscribe [Sec.13(c)].
8. To be indemnified by the firm in respect of liabilities incurred by him in the ordinary course of business [Sec.13 (e)].
9. To continue in the partnership, i.e., not to be expelled. A partner may, however, be expelled if a power to expel is conferred upon the partners and power is exercised bona fide by a majority of partners [Sec.33 (i)].

10.4.2 Duties of Partners

Sec.9 provides for general duties of partners. (i) They are bound to (a) carry on the business of the firm to the greatest common advantage, (b) to be just and faithful to each other and (c) to render true accounts and full information of all things affecting the firm to any partner or his legal representative. (ii) Every partner shall indemnify the firm for loss caused to it by his fraud in the conduct of the business of the firm (Sec.10). (iii) To attend diligently to his duties in the conduct of the firm's business without any remuneration [Sec.13(a)]. (iv) If restrained by an agreement with other partners, a partner has a duty not to carry on any business other than that of the firm while he is a partner [Sec.11 (2)]. (v) If a partner carries on any business competing with that of the firm, he shall account for and pay to the firm all profits made by him in that business [Sec.16(b)].

10.5 Relations of Partners to Third Parties

Subject to Sec.18 every partner is the agent of the firm for the purposes of the business of the firm.

10.5.1 Implied Authority of a Partner

A partner's authority may be express or implied. It is express, when it is fixed between the partners by mutual agreement. The agreement may, however, be oral or written. It is implied when the law impliedly gives certain powers to a partner, i.e., the law presumes that every partner has the power to do certain acts unless negative by an express agreement.

Secs.19 and 22 deal with the subject of implied authority of a partner.

10.5.2 Liabilities of a Partner

Liability of a partner stems from not complying with his duties under the Partnership Act. Thus, in view of Sec.9, a partner shall be liable for (i) not carrying on the business of the firm to the greatest common advantage; (ii) not being just and faithful to other partners and (iii) failure to render true accounts and full information of all things affecting the firm to any partner or his legal representative.

Notes

10.5.3 Liability of a Firm for Wrongful Acts of a Partner (Secs.26-27)

Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party or any penalty is incurred, the firm is liable therefore to the same extent as the partner.

Task Iqbal Singh, a partner in a firm purchased some goods which were stolen. Later, he sold the goods. The firm's accounts showed the transaction. Is the firm liable to the true owner?

Case Study

Partnership

If she weren't a shade confused, she wouldn't be Wafers! Her uncle, a star CFO, was her inspiration and she wished to be like him - jet setting, globe trotting and knowledgeable. At the campus interview her senior had picked a job for Rs 9 lakh and gosh he wasn't even a rank holder. Wafers knew that the industry offered fat pay packs but her heart actually lay in consulting. She wanted to join one of the Big Four firms with the long-term goal of becoming the next C.

K. Prahalad. Her professor had once told the class, "In life, you should do what the heart tells you." He was talking about careers! China said, "For chartered accountants there are a plethora of opportunities in the new international trading regime." Wafers agreed. She recalled reading in the ICAI website that "Opportunities would emerge at three fundamental levels in the WTO regime. At the government level, at the revenue authorities level and at the business unit level." China was surprised. "Wow! These CA students are so analytical," he told himself. "You mean to say, accounting firms will have opportunities at the international level," queried Muskan, Wafer's niece. She was in Class X.

"Yeah," said Wafers. And added, "Actually, the opportunities are not just in the industry. They are in practice as well." China remarked, "But that comes with a huge price. If the pink papers are to be believed, accounting firms in the US have millions of dollars worth of legal suits pending against them." Muskan asked, "So?" "So," replied China, "the liberalised trade scenario which offers potential to provide services across international borders will augment greater liability to firms in case of default." Muskan looked definitely confused.

Wafers explained. "Legally, accounting firms in India are allowed to function as sole proprietary concerns or as partnership firms. A partnership is the relationship between persons who have agreed to share the profits of a business carried on by all or anyone of them acting for all." This set Muskan thinking. "So will I be liable for my partners' shortcomings even if I have been honest in conducting my duties," she asked. "That's the general idea," said China impressed by the kid asking the right questions.

"This traditional model is not equipped to meet the multi-competency, multi-disciplinary and multi-locational requirements of today's global and domestic clients," said China.

Wafers added, "Moreover, the major chunk of all benefits is drawn by the creamy layer of large firms." She had read a research report on "Who are India's top auditors and how much do they charge," which had, among others, documented the great divide in the accounting profession. "This is why the accounting fraternity is in favour of limited liability

Contd....

Notes

partnership," (LLP) she added. "But what is LLP?" asked China. Ha, that's why she loved China. The walking encyclopaedia had no inhibitions about seeking a clarification on a doubt, if he had one.

"A limited liability partnership is a form of organisation which shields a partner's assets from limitless liabilities that may accrue from the omissions and commissions of other partners," answered Wafers. Not for nothing was Wafers considered strong in law. "In LLP, every partner will be an agent of the partnership and not of the other partners," she added. "Isn't this a merger of the partnership form of organisation and the company form?" remarked China.

"Exactly," said Wafers. "It promises perpetual succession and a distinct legal identity were it to become law. Further, it requires only a minimum of two partners, having no cap on the maximum number of partners a firm can have," she added. "Sec.11," said China hurriedly, "of the Companies Act bars the formation of a partnership consisting of more than 20 persons. Won't the firm have to register itself as a company?" "Yes and No." said Wafers "If LLP becomes law, Sec.11 will have to be amended. The idea is to make LLP a vehicle for business expansion.

"How?" asked Muskan. Replied Wafers, "Because of the legal stipulation of unlimited liability among partners, Indian partnerships are mostly restricted to family members and persons who know each other thoroughly." She added, "LLP being a form of partnership having characteristics of a company will limit liability in the case of business failure or professional negligence litigation to the partner responsible." "You mean, only the negligent partner will be penalised and not the whole firm," asked China. "Yes," said Wafers.

China played the devil's advocate. "Is it possible to prove that only a particular partner was negligent and not the others?" Wafers replied, "They will have to divide work amongst themselves appropriately. This could create disputes between partners, but crystal clear division of duties between partners will go a long way in reducing the same."

"Excellent," said Muskan. "The LLP form of organisation would help the small and medium practitioners by encouraging networking and specialisation of functions."

Wafers had a word of caution, "The decision to go for LLP will be based on the interplay of costs and benefits." China continued his black hat thinking, "Other forms of organisation are tried and tested. Why then should one go for something new?" Wafers answered this question philosophically quoting John Rockefeller, "If you want to succeed, you should strike out new paths rather than travel the worn out paths of accepted success." China smiled.

Question

Comment on "A partnership is the relationship between persons who have agreed to share the profits of a business carried on by all or anyone of them acting for all". (***Hints:*** Refer partnership act).

10.6 Summary

- A partnership is defined as "the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all".
- A club is an association of persons with the objective of promotion of some beneficial or social object such as promotion of health or providing recreation for its members. The minimum number of persons required to form a partnership is 2.

Notes

- A partnership can be formed for genuine business purposes which are not illegal or prohibited by law. The liability of certain partners is limited to the amount of capital which they have agreed to contribute to the business.
- The two sections when read together provide that the act of a partner which is done to carry on in the usual way, business of the kind carried on by the firm, binds the firm, provided the act is done in the firm's name, or in any manner expressing or implying an intention to bind the firm. Such authority of a partner to bind the firm is called his implied authority.

10.7 Keywords

Dissolution: Dissolution (law), in law, means to end a legal entity or agreement such as a marriage, adoption, or corporation.

Firm: Any business entity such as a corporation, partnership, limited liability company, sole proprietorship, or "private equity" "investment (firm) organization"

Partnership: A partnership is a type of business entity in which partners (owners) share with each other the profits or losses of the business.

Proprietorship: A proprietorship is a company which is not registered with the state as a limited liability company or corporation.

10.8 Self Assessment

State whether the following statement is true or false:

1. An unregistered partnership is illegal.
2. An unregistered partnership firm is not illegal but its rights are not enforceable.
3. It is obligatory for a firm to be registered under the Indian Partnership Act.
4. A firm is liable for the wrongful acts of a partner.
5. The Indian Partnership Act has effectively ensured the registration of firms without making it compulsory.
6. A person can be admitted as a partner in a firm with the consent of the majority of partners.
7. A minor can be a partner in a firm.
8. There can be thirty partners in a firm.
9. 'Partnership' and 'firm' are synonymous.
10. A firm can enter into a partnership agreement with another firm.

Fill in the blanks:

11. A partner is not entitled to claim ..... .
12. Sharing of profits is a conclusive evidence of ..... .
13. Registration of a partnership firm is effective from the date when the registrar files the statement & makes entries in the ..... .
14. A firm cannot sue a person for the price of goods it ..... .
15. Dissolution of firm by agreement come under ..... .

Notes

10.9 Review Questions

1. (a) What is a partnership? (b) Briefly state special features of a partnership on the basis of which its existence can be determined under the Indian Partnership Act?
2. (a) Explain the procedure for getting a partnership firm registered. When is such a registration treated as complete? (b) State the effects of non-registration of a firm. (c) What are the advantages of registration of a partnership firm?
3. Explain the following: (i) Partner by holding out, or by estoppel. (ii) Dormant or sleeping partner. (iii) Nominal partner. (iv) Sub-partner. (v) Working partner. (vi) Incoming partner. (vii) Outgoing partner. (viii) Limited partnership.
4. What are the provisions of the Indian Partnership Act with regard to the admission of a minor into the partnership? What will be his rights and liabilities during his minority and after he has attained the majority?
5. Enumerate the rights and duties of partners inter se.
6. What is meant by the implied authority of a partner to bind the firm? State the acts of a partner for which he does not have the implied authority to bind the firm.

Answers: Self Assessment

1.	False	2.	True
3.	False	4.	True
5.	True	6.	False
7.	False	8.	False
9.	True	10.	True
11.	Remuneration	12.	partnership
13.	Sec.40	14.	Register of firms
15.	supplied		

10.10 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

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Notes

Unit 11: Types of Partners

CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss different types of partners
- Describe dissolution and types
- Discuss the Limited Liability Partnership Act, 2008

Introduction

In last unit you have studied about partnership. The choice will depend upon the considerations such as the type of the product, capital requirements, government control, legal requirements, competitive conditions in the chosen industry, and level of taxation, ownership privileges and the like.

A partnership is defined as "the relationship between persons who have agreed to share profits of a business carried on by all, or by any of them acting for all". On analysis of the definition, certain essential elements of partnership emerge.

Notes

An agreement presupposes a minimum number of two persons. As mentioned above, a partnership to arise, at least two persons must make an agreement. Partnership is the result of an agreement between two or more persons. In this unit you will study about different types of partners.

11.1 Changes in a Firm

The Act contemplates the following changes in a firm:

1. Change in the duration of a firm;
2. Change in the nature of business or undertakings, and
3. Change in the constitution of a firm.

A partnership may be entered into for a fixed period of time. When the fixed period is over, it comes to an end. However, the partners may carry on the business even after the expiry of the fixed period and the partnership becomes 'partnership at will'. Sec.12(c) provides that subject to contract between the partners no change may be made in the nature of the business without the consent of all the partners.

11.1.1 Rights and Liabilities of Incoming Partners

Sec. 31 provides that subject to a contract between partners and to the provisions regarding minors in a firm, no new partner can be introduced into a firm without the consent of all the existing partners. Such a partner enjoys all the rights as are conferred upon him by the Act and by the contract between him and the existing partners. The liability of a new partner ordinarily commences from the date when he is admitted as a partner, unless he agrees to be liable for obligations incurred by the firm prior to that date. But such an agreement is binding only on the partners and does not give the right to any creditor of the firm to sue the new partner for past debts of the firm. This is because there is no privacy of contract between the creditor and the new partner. At the same time, the acts of the old partners cannot be ratified by the new partner. This is in accordance with Sec. 196 of the Indian Contract Act, 1872, which provides that for the purpose of ratification of agency, the principal must be in existence at the time when the act was done.

11.1.2 Rights and Liabilities of a Retired Partner

An outgoing partner means a partner who has retired from a firm. The firm is reconstituted by the remaining partners. Sec.32 contemplates three ways in which a partner may retire from the firm, *viz.*, (i) he may retire at any time with the consent of all other partners; (ii) where there is an agreement between the partners about retirement, a partner may retire in accordance with the terms of that agreement; (iii) where the partnership is at will, a partner may retire by giving to his partners a notice of his intention to retire. Sec.32 clearly comprehends a situation where a partner may retire without dissolving the firm.

Liability of the retired partner. Sec.32 provides that a retired partner continues to be liable for all the acts of the firm done before his retirement unless he is discharged from his liability. He may be discharged from liability to any third party for the acts of the firm done before his retirement if (a) there is an agreement made by him with such third party and the remaining partners. (This implies the principle of novation); (b) there is an implied agreement to the above effect. Such an agreement may be implied by a course of dealing between such third party and the remaining partners, after the third party had knowledge of the retirement.

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11.1.3 Expulsion of a Partner

Sec. 33 provides that a partner may not be expelled from a firm by a majority of partners except in exercise, in good faith, of powers conferred by the contract between the partners. Thus, a partner may be expelled from the firm if (i) the power of expulsion is conferred by a contract between the partners, (ii) the power is exercised by a majority of the partners and (iii) the power is exercised in good faith. The test of good faith will be satisfied if (i) the expulsion is in the interest of the partnership, (ii) a notice of expulsion has been served on the partner and (iii) the partner to be expelled has been given an opportunity of being heard.

11.1.4 Insolvency of a Partner

Sec.34 provides that where a partner in a firm is adjudicated insolvent, he ceases to be a partner on the date on which the order of adjudication is passed whether or not the firm is thereby dissolved. It is to be noted that ordinarily but not invariably, the insolvency of a partner results in dissolution of a firm but the partners may specifically provide that on such a contingency the firm shall not be dissolved.

11.1.5 Death of a Partner

Sec.42(c) provides that a firm is dissolved by the death of a partner, in the absence of a contract to the contrary. Sec.35 deals with a situation where after the death of a partner, the firm continues its business without dissolution and provides that the estate of the deceased partner is not liable for any act of the firm done after his death. Proviso to Sec.45 lays down an identical rule applicable to a case where the death of a partner has caused dissolution of the firm. A public notice of the death of a partner is not required.

11.1.6 Transfer of Partner's Interest

A partner may transfer his interest in the firm by sale, mortgage or charge. The transfer may be absolute or partial. But as the partnership relationship is based on mutual confidence, the assignee of a partner's interest cannot enjoy the same rights and privileges as the assignor Sec.29 provides that the transferee, during the continuance of the firm, is not entitled to (i) interfere in the conduct of business of the firm or (ii) require accounts of the firm, or (iii) inspect books of the firm.

11.2 Types of Partners

There are different types of partners. A person who deals with a firm may have to ascertain, at some time or the other (such as where the firm has made a default) as to not only who the partners are, but also to what extent each is liable. The liability is different for different classes of partners.

1. ***Actual, active or ostensible partner:*** Such a partner is a person who becomes a partner by an agreement, brings capital, actively participates in the functions and management of the business and shares its profits and losses. He binds himself and other partners, so far as third parties are concerned, for all the acts done by him in the ordinary course of the business and in the name of the firm. Such a partner must give a public notice of his retirement from the firm in order to absolve himself from the liability for the acts of the other partners done after his retirement.
2. ***Sleeping or dormant partner:*** A sleeping partner is one who does not take an active part in the business of the firm. Sometimes he is called as a financing partner as he contributes to the capital only but does not participate in the management of the business. Such a

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partner is liable like any other partner of the firm for the debts of the firm, even though his existence is kept a secret from the parties dealing with the firm. His position may well be compared with an undisclosed principal.

3. ***Nominal partner:*** Sometimes persons lend their names and credit to the firm but neither contribute any capital nor take active part in the management of the business. Such partners are called nominal partners. As the title suggests, such persons are partners only in name. His name is used as if he were a partner of the firm, though actually he is not.

4. ***Partner in profits only:*** If a partner is entitled to a certain share of profit without being liable for the losses, he is known as partner in profit only. He is not allowed to take part in the management of the firm, but is liable for all the acts of the firm.

5. ***Sub-partner:*** A sub-partnership comes into existence when one of the partners agree to share the profits derived by him from the firm with a third person. This third person is called a 'sub-partner'.

6. ***Partner by estoppel or holding out:*** Sometimes a person who is not a partner in a firm may under certain circumstances, be liable for its debts as if he were a partner. Such a person may be either a partner by estoppel or a partner by holding out. If any person behaves in such a way that others consider him to be a partner, he will be held liable to those persons who have been misled and lent finance to the firm on the assumption that he is a partner. Such a person is known as a partner by estoppel. He is not a true partner of the firm is and also not entitled to any share in the profits of the firm.

Example: A partner retires from a firm but does not give notice of his retirement. He is a partner by holding out.

7. ***Working partner:*** A partner, because of his special qualifications, may be assigned the management and control of business. Such a partner is known as 'working partner'. A working partner normally receives a fixed amount of salary, besides his share in the profits of the firm. Other partners, however, remain liable to the third parties for all his acts.

8. ***Incoming partner:*** Section 31 provides that subject to the contract between the partners and to the provisions of s.30 (which deals with the position of a minor partner) a person can be introduced as a partner into a firm with the consent of all the existing partners. Thus, a person who is admitted as a partner into an already existing firm with the consent of all the existing partners is called an 'incoming partner'.

9. ***Outgoing partner:*** A partner who leaves a firm in which the rest of the partners continue to carry on business is called an 'outgoing' or retiring partner. A partner may retire: (i) with the consent of all the other partners; (ii) in accordance with an express agreement by the partners; or (iii) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire [s.32 (1)].

10. A ***retiring partner*** continues to remain liable to third parties for all the acts of the firm until public notice is given of his retirement. Such a notice may be given either by the retiring partner or by any member of the reconstituted firm.

11.3 Dissolution

11.3.1 Dissolution of Firm and Dissolution of Partnership

Sec.39 provides that the dissolution of partnership between all the partners of a firm is called the "dissolution of the firm". It follows that if the dissolution of partnership is not between all the partners, it would not amount to "dissolution of firm", but it would nevertheless be "dissolution

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of partnership". Thus, dissolution of firm always implies dissolution of partnership, but dissolution of partnership need not lead to dissolution of firm. Dissolution of partnership may involve merely a change in the relation of the partners and not the dissolution of the firm.

11.3.2 Dissolution of Firm

When the relationship existing between all the partners of the firm comes to an end, it is called dissolution of the firm. It naturally involves closing down the business. There is no question of 'reconstituted firm' in such a case. A firm may be dissolved in any of the following ways:

1. ***By mutual consent.*** Sec.40 provides that a firm may, at any time, be dissolved with the consent of all the partners. This applies to all cases whether the firm is for a fixed period or otherwise.
2. ***By agreement.*** Sec.40 also provides for the dissolution of a firm in accordance with a contract between the partners. The contract providing for dissolution may have been incorporated in the partnership deed itself or in a separate agreement.
3. ***By the insolvency of all the partners but one.*** If all the partners or all the partners but one become insolvent, there is a dissolution of the firm. Sec.41 calls this as compulsory dissolution.
4. ***By business becoming illegal.*** Sec.41 provides that a firm is dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership. But, if the partnership relates to more than one adventure, the illegality of one or more of them does not prevent the lawful adventure from being carried on by the firm.
5. ***Partners becoming alien enemies.*** Sec.41 also covers cases of partnership between persons some of whom become alien enemies by a subsequent declaration of war. In such a case partnership is dissolved, because trading with an alien enemy is against public policy.

11.3.3 Dissolution by Court (Sec.44)

At the suit of a partner, the court may dissolve a firm on any of the following grounds:

1. ***If a partner has become of unsound mind.*** The application in this case may be made by any of the partners or by the next friend of the insane partner. In the case of insanity of a dormant partner, the court will not order dissolution, unless a very special case is made out for dissolution.
2. ***Permanent incapacity of a partner.*** The court may order for dissolution of partnership, if a partner becomes permanently incapable of performing his duties as a partner. The application for dissolution, in such a case, may be made by any of the partners and not by the incapacitated partner.
3. ***Misconduct of a partner affecting the business.*** If a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business of the firm, the court may order dissolution.
4. ***Willful and persistent disregard of partnership agreement by a partner.*** If a partner willfully and persistently commits a breach of the partnership agreement regarding management, or otherwise conducts himself in such a way that is not reasonably practicable for the other partners to carry on business in partnership with him, the court may order dissolution. Continuous refusal by a partner to attend to his duties in the partnership business, the fact of hostility between the partners which makes cooperation between them impossible, have been held to be sufficient reasons for dissolution. The suit for dissolution under this ground can be brought by a partner other than the guilty partner.

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5. ***Transfer of interest or share by a partner.*** If a partner transfers, in any way (e.g., by sale, mortgage or charge), his whole interest in the partnership to a third party (outsider) or allows his share to be charged in execution of a decree against him or allows the same to be sold for arrears of land revenue or for charges recoverable as land revenue, the court may dissolve the partnership. The transfer of a part of his share by a partner to any third party is not permissible unless otherwise agreed. A partner can, however, transfer even the whole of his share to a partner in the firm, because no new partner is introduced thereby.

6. ***The court can also dissolve partnership*** where the business of the firm cannot be carried on save at a loss. The court can order dissolution even though the partnership is for a fixed period [Rehmat-un-nisa-v. Price, 42 Bom. 380].

7. ***Just and equitable.*** The court can order dissolution on any other ground which in the opinion of the court is a fit ground for dissolution of partnership. Dissolution on this ground has been granted in case of deadlock in the management, disappearance of the substratum of the business, partners not on speaking terms, etc.

Task Arjun, a partner in a firm was found guilty of embezzlement of funds belonging to a client. The other partner filed a suit for the dissolution of the firm on the ground that it is just equitable that the firm be dissolved. Would he succeed?

11.4 Overview of the Limited Liability Partnership Act, 2008

As we know a Limited Liability Partnership firm ("LLP") is a form of business organisation with each partner's liability limited to the contribution made by that partner in relation to the LLP, except in case of fraud, malpractice, wrongs, etc., in which case liability that can attach to the relevant partner may be unlimited liability.

Much awaited and talked about "Limited Liability Partnership Act, 2008" ultimately received the assent of the President of India on 7th January 2009. This piece of legislation is especially useful and beneficial to small traders, businessmen and professionals. It has opened up an altogether new vista for the small entrepreneurs, service providers and professionals who are afraid of various compliances of the bulky Companies Act, 1956.

As far as professionals are concerned (Lawyers, Chartered Accountants, Company Secretaries, Cost & Works Accountants), it has really opened a new arena as almost all the professional bodies restrict conducting of the professional practice in corporate umbrella, though partnership form of organization is not prohibited. Thus, with the enactment of the LLP Act such professionals and small entrepreneur, can take almost all the major benefits of Corporates but at the same time will not be subject to the vagaries of various compliances of the Companies Act, 1956.

The Limited Liability Partnership Act, 2008 has all the tapping of a Corporate Entity *i.e.,* all the benefits of Private/Public Limited Company (except to approach the Capital market and also issuance of various corporate debt and equity instruments) are available to a Limited Liability Partnership Firm (LLP Firm).

Agency: Every partner is an agent of the LLP and not of the other partners.

Unauthorized Acts: An LLP is not bound by unauthorized acts of any partner in dealing with a third person provided such third person is aware that the acts are unauthorized; or does not know or believe that the partner is a partner of the LLP.

Wrongful Acts or Omissions: An LLP is liable for wrongful acts or omissions of partners in the course of business of the LLP or with its authority – The partner(s) committing such act or omission will be personally liable – Other partners not to be liable for such wrongful act or

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omission. An obligation of the limited liability partnership is solely the obligation of the limited liability partnership. The liabilities of the limited liability partnership shall be met out of the property of the limited liability partnership. Accordingly, unlike the Texas first law, even liability for debt is limited.

Right to Share Profits Transferable

Right of a partner to share profits is transferable (either wholly or in part) Transfer does not imply that the transferor/assignor has ceased to be a partner. Transferee/ assignee not entitled to participate in the management of the LLP. Transferee/assignee not entitled to any information relating to transactions of LLP.

Statements of Accounts and Solvency: An LLP must prepare a 'Statement of Accounts' and 'Solvency Statement' within a period of 6 months from the end of the financial year to which the statement or solvency relates - The statements must be filed with the Registrar.

Annual Return: Every LLP must file in Form 11 an annual return with the Registrar within 60 days of the end of the financial year – the annual return should be accompanied by a certificate from a company secretary confirming the veracity of the particulars/statements contained in such annual return.

Partnership Firm: An existing partnership firm may be converted into an LLP. The partners of the LLP, on conversion, must comprise all the partners of the original partnership firm and no one else.

Private Company: A private limited company registered under the Companies Act, 1956 can convert itself into an LLP. A company may apply for conversion provided all the shareholders of the Company and no one else shall be partners of the LLP.

Unlisted Public Company: An unlisted Public Company registered under the Companies Act, can convert itself into an LLP. A company may apply for conversion provided all the shareholders of the Company and no one else shall be partners of the LLP. A listed Public Ltd. Company cannot convert into an LLP.

Foreign LLPs: The Act states that the Central Government may make Rules for establishment of place of business for foreign LLPs in India and conduct of business by such foreign LLPs. Provisions relating to setting up foreign LLP establishments in India are contained in the Rules framed in this regard.

Compromise, arrangement and reconstruction: The Act provides for compromise and arrangement between the LLP and its creditors/partners. The Act also provides for reconstruction of LLPs. The Relevant provisions are contained in Chapter XII of the Act (Sections 60 – 65).

Defunct LLP: The Registrar has the power to strike off the name of an LLP from the register if the LLP is not carrying any business or operation in accordance with the Act and the Rules. An application can also be made in this regard in Form 24 to the Registrar. (Section 75 and Rule 37 of the Rules).

11.5 Summary

- A retiring partner continues to remain liable to third parties for all the acts of the firm until public notice is given of his retirement.
- The relationship of partnership arises from an agreement between the persons concerned not from status.
- Agreement as made between the persons must be valid and enforceable by law. This agreement may be oral or written.

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- To avoid future complications and dispute amongst the persons constituting partnership, agreement in writing must be preferred.
- A partnership is formed by an agreement between the partners. The rights and obligations of the partners towards each other and towards the firm can be determined by an oral or written agreement.
- To avoid future dispute it is always advisable to have partnership expressed in writing.

11.6 Keywords

Sleeping partner: It is one who does not take an active part in the business of the firm.

Sub-partnership: It comes into existence when one of the partners agree to share the profits derived by him from the firm with a third person. This third person is called a 'sub-partner'.

11.7 Self Assessment

Fill in the blanks:

1. A partner may transfer his interest in the firm by sale, ... or charge.
2. A person who deals with a firm may have to ascertain, at some time or the other (such as where the firm has made a default) as to not only who the partners are, but also to what extent each is ..... .
3. If a partner is entitled to a certain ..... without being liable for the losses, he is known as partner in profit only.
4. ..... that the dissolution of partnership between all the partners of a firm is called the "dissolution of the firm".

11.8 Review Questions

1. Write a short note on 'liability of a firm for wrongful acts of a partner'.
2. Explain the conditions under which a partner may be expelled from the firm. State the consequences of such an expulsion.
3. In what circumstances is partnership dissolved: (i) automatically, (ii) compulsorily by the court?
4. What is meant by dissolution of a firm? Is it different from the dissolution of partnership?
5. Describe the mode of settling accounts of a firm after dissolution with special reference to a case where one of the partners has become insolvent and nothing is recoverable from his estate.

Answers: Self Assessment

1. mortgage
2. liable
3. share of profit
4. Sec.39 provides

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11.9 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://www.dateyvs.com/gener04.htm

http://www.mp.gov.in/registrarfirms/IPA1932English.pdf

http://www.lawcom.gov.uk/docs/cp159sum.pdf

Unit 12: Law of Sales of Goods

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CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss essential of contract of sale
- Describe conditions and warranties

Introduction

In last unit, you have studied about the Indian Contract Act, 1872. Transactions in the nature of sale of goods form the subject matter of the Sale of Goods Act, 1930. The Act covers topics such as the concept of sale of goods, warranties and conditions arising out of sale, delivery of goods and passing of property and other obligations of the buyer and the seller. It also covers the field of documents of title to goods and the transfer of ownership on the basis of such documents. The Act came into force on 1st July, 1930. It extends to the whole of India, except Jammu and Kashmir. The sections quoted in this unit refer to the Sale of Goods Act, 1930, unless otherwise stated. This unit, deals with the specific types of contract, i.e., sale of goods. In looking at this topic we see how the principles of contract form its basis.

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12.1 Contract of Sale

Sec.4 defines a contract of sale as 'a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price'. From the definition, the following essentials of the contract emerge:

1. ***There must be at least two parties.*** A sale has to be bilateral because the property in goods has to pass from one person to another. The seller and the buyer must be different persons. A person cannot buy his own goods. However, a part-owner may sell to another part-owner.

Example: A partnership firm was dissolved and the surplus assets, including some goods, were divided among the partners in specie. The sales-tax officer sought to tax this transaction. Held, this transaction did not amount to sale. The partners were themselves the joint owners of the goods and they could not be both sellers and buyers. Moreover, no money consideration was promised or paid by any partner to the firm as consideration for the goods allotted to him.

2. ***Transfer or agreement to transfer the ownership of goods.*** In a contract of sale, it is the ownership that is transferred (in the case of sale), or agreed to be transferred (in the case of agreement to sell), as against transfer of mere possession or limited interest (as in the case of bailment or pledge).

3. ***The subject matter of the contract must necessarily be goods.*** The sale of immovable property is not covered under Sale of Goods Act. The expression 'goods' is defined in Sec.2(7).

4. ***Price is the consideration of the contract of sale.*** The consideration in a contract of sale has necessarily to be 'money', (i.e., the legal tender money). If for instance, goods are offered as the consideration for goods, it will not amount to sale. It will be called'barter'.

   Payment by installments. In the case of sale of goods, the parties may agree that the price will be payable by installments. Also, the terms may stipulate some amount by way of down payment and the balance by installments.

Sale and Agreement to Sell

Where under a contract of sale, the property (ownership) in the goods is transferred from the seller to the buyer, it is called a sale [Sec.4(3)]. Thus, sale takes place when there is a transfer of ownership in goods from the seller to the buyer. A sale is an executed contract.

Example: Ramanathan sells his car to Bhim for ₹ 1 lakhs. If all essential elements of a valid contract are present, it is a sale and therefore the ownership of the car stands transferred from Ramanathan to Bhim. This is so even where the payment of the price or the delivery of the car or both have been postponed.

Agreement to sell means a contract of sale under which the transfer of property in goods is to take place at a future date or subject to some conditions thereafter to be fulfilled.

Distinction between Sale and Agreement to Sell

The distinction between the two is of prime importance as they have different legal repercussions. The rights and duties of the parties vary with the fact whether the contract of sale is an actual sale or an agreement to sell. In a sale, the seller transfers the ownership in the goods at the time of entering into the contract; in the agreement to sell, the ownership is agreed to be transferred later.

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12.2 Goods and their Classification

12.2.1 Meaning of Goods

'Goods' means every kind of movable property, other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. Thus, things like trade marks patents, copyright, goodwill, water, gas, electricity are all goods and therefore, may be the subject matter of a contract of sale. In general, it is only the movables, i.e., things which can be carried from one place to another that form 'goods'. Landed property, therefore, does not constitute goods.

12.2.2 Classification of Goods

Goods may be classified as existing, future and contingent. Existing goods are those which are owned or possessed by the seller at the time of the contract (Sec.6). Instances of goods possessed but not owned by the seller are sales by agents and pledges. Existing goods may be either (a) specific or ascertained; or (b) generic and unascertained. Specific goods means goods identified and agreed upon at the time a contract of sale is made [Sec.2(14)]. Ascertained goods, though normally used as synonym for specific goods may be intended to include goods which have become ascertained subsequently to the formation of the contract. Generic or unascertained goods are goods indicated by description and not specifically identified.

Example: Anthony, who owns a TV show room, has 20 TV sets and agrees to sell any one of them to Bharti. The contract is for unascertained goods, since which particular TV set shall become the subject matter of sale is not individualised at the time of the contract of sale.

Future goods means goods to be manufactured or produced or acquired by the seller after making the contract of sale [Sec.2(6)].

Example: Kulkarni agrees to sell future crop of a particular agricultural field in the next season. This is an agreement to sell future goods.

Contingent goods are the goods the acquisition of which by the seller depends upon a contingency which may or may not happen [Sec.6(2)]. Contingent goods are a part of future goods.

Example: Alka agrees to sell to Bhola a certain painting only if Chetan, its present owner, sells it to her. This painting is classified as contingent goods.

12.3 Definitions of Contract of Sales

Definition (S. 2)

Buyer: "Buyer" means a person who buys or agrees to buy goods.

Seller: "Seller" means a person who sells or agrees to sell goods.

Delivery: "Delivery" means voluntary transfer of possession from one person to another.

Deliverable State: Goods are said to be I a deliverable state when they are in such state that the buyer would, under the contract, be bound to take delivery of them.

Document of title to goods: "Document of title to goods" includes a bill of lading, clock warrant, warehouse-Keeper's certificate, wharfinger's certificate, railway receipt, warrant or order for the delivery of goods, and any other document used in the ordinary course of business as proof of

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the possession or control of goods, or authorizing the possessor of the document to transfer or receive goods thereby represented.

A railway receipt is a document issued by the Railway Company which is to be handed over at the destination of the goods, in return for the delivery of the goods named in such document.

A bill of lading has been defined by Scruttion as "a receipt for goods shipped on board a ship, signed by the person who contracts to carry them or his agent, and stating the terms on which the goods were delivered to and received by the ship.

A dock-warrant is a document issued by a dock or wharf owner setting out the detailed measurements (or weight) of a specific parcel of goods, and declaring or certifying that the goods are held to the order of the person named therein.

A warehouse-keeper's certificate or a wharfinger's certificate is a document which is issued by the warehouse-keeper or wharfinger, stating that certain goods which are specified in the certificate are in his warehouse. However, such a certificate, to be a document of title, must be in the nature of a warrant.

Future goods: "Future goods" means goods to be manufactured or produced or acquired by the seller after the making of the contract of sale.

Specific goods: "Specific goods" means goods identified and agreed upon at the time a contract of sale is made.

Insolvent: "Insolvent" A person is said to be "insolvent" who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not.

Mercantile agent: "Mercantile agent" means a mercantile agent having in the customary course of business as such agent, authority (i) to sell goods, or (ii) to consign goods for the purpose of sale, or (iii) to buy goods, or (iv) to raise money on the security of goods.

Price: "Price" means the money consideration for a sale of goods.

Property: "Property" means the general property in goods, and not merely a special property.

Quality of goods: "Quality of goods" includes their state or condition.

12.4 Meaning of Price

12.4.1 Meaning

Price means the money consideration for the sale of goods. Price is an integral part of a contract of sale. If price is not fixed, or is not capable of being fixed, the contract is void ab initio. As to how the price is to be fixed Secs.9 and 10 lay down certain rules. According to Sec.9, the price may (i) either be fixed by the contract, or (ii) agreed to be fixed in a manner provided by the contact, e.g., by a valuer or (iii) determined by the course of dealings between the parties.

Example: In a particular trade, there is a usage to deduct discount in determining the price. The usage is implied by the course of dealings between the parties.

12.4.2 Mode of Payment of the Price

The seller is not bound to accept any kind of payment – except in legal tender money unless there is an agreement express or implied to the contrary or unless the seller is estopped from disputing the mode of payment. Thus, he is not bound to accept payment by cheque.

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Earnest money *a*lso known as deposit, it is paid by the buyer in advance as security for the due performance of his part of the contract. It is not paid as part payment of price. If the transaction goes through, the earnest money is adjusted against the price. But if the sale goes off through buyer's fault, the deposit unless otherwise agreed is forfeited to the seller; and where it goes off by the seller's default he must return the earnest money.

12.5 Conditions and Warranties (Sec.11-17)

In a contract of sale, parties make certain stipulations, i.e., agree to certain terms. All stipulations cannot be treated on the same footing. Some may be intended by the parties to be of a fundamental nature, e.g., quality of the goods to be supplied, the breach of which, therefore, will be regarded as a breach of the contract. Some may be intended by the parties to be binding, but of a subsidiary or inferior character, e.g., time of payment, so that a breach of these terms will not put an end to the contract but will make the party committing the breach liable to damages. The former stipulations are called 'conditions' and the latter 'warranties'.

Breach of condition to be treated as breach of warranty (Sec.13). Under certain circumstances a breach of condition is to be treated as a breach of warranty, i.e., the right to repudiate the contract is deemed to have been lost. These circumstances are:

1. Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may either (a) waive the condition, or (b) elect to treat the breach of the condition as a breach of warranty. In such situations, the buyer is active and is either waiving the condition or electing to treat the breach of condition as a breach of warranty. If the buyer decides to waive the condition, he cannot later on insist that the condition be fulfilled. Where the buyer treats the breach of condition as a breach of warranty, he has to give a notice to the seller to that effect.
2. There is also a compulsory treatment of breach of condition as a breach of warranty. Where the contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty. However, the agreement may provide otherwise, i.e. may permit repudiation of the contract in spite of the acceptance of the goods by the buyer.

Express and implied conditions and warranties. Conditions and warranties may be either express or implied. They are said to the 'express' when the terms of the contract expressly, provide for them. They are said to be 'implied' when the law deems their existence in the contract even without their actually having been put in the contract. However, an implied condition or warranty may be negative by an express term to the contrary. Sec.62 recognizes the following two principles: (i) what is expressed makes what is implied to cease and (ii) custom and agreement overrule law.

Express condition or warranty. These may be of any kind that the parties may choose to agree upon, e.g., it may be agreed that delivery of goods shall be made or taken on or before a certain date. Similarly, in a contract of sale of a car, express warranty as to its soundness may be incorporated.

Implied conditions and warranties [Secs.14-17]. Implied conditions and warranties are deemed to be incorporated by law in every contract of sale of goods unless the terms of the contract show a contrary intention. The implied conditions: (i) condition as to title (Sec.14), (ii) sale by description (Sec.15), (iii) condition as to quality or fitness for buyer's purpose (Sec.16(1)), (iv) condition as to merchantable quality [Sec.16(2)], (v) condition as to wholesomeness, (vi) implied condition in the case of sale by sample (Sec.17), (vii) implied condition in the case of sale by sample as well as description (Sec.15).

Notes

Doctrine of Caveat Emptor

The doctrine of caveat emptor is a fundamental principle of the law of sale of goods. It means 'CAUTION BUYER', i.e., 'let the buyer beware'. In other words, it is no part of the seller's duty to point out defects of his own goods. The buyer must inspect the goods to find out if they will suit his purpose.

Task Raman sold 100 quintals of rice to Suman, who paid by cheque. The cheque was dishonoured upon presentation. Raman had given a delivery order to Suman. Suman resold it to Gagan, a buyer in good faith, for consideration, endorsing the delivery order to him. Raman refuses to deliver the goods to Gagan, on the plea of non-payment. Advice Gagan.

12.6 Passing of Property in Goods

12.6.1 Meaning of 'Property in Goods'

The phrase 'property in goods' means ownership of goods. The 'ownership' of goods is different from 'possession' of goods. The 'possession' of goods refers to the custody of goods, though normally a person who is in possession of the goods shall also be its owner but it need not necessarily be so.

12.6.2 Rules regarding Passing of Property in Goods from the Seller to the Buyer

Secs.18 to 25 lay down the rules which determine when property passes from the seller to the buyer. These rules for different kinds of goods are summarised below:

Specific or ascertained goods. In a sale of specific or ascertained goods, the property in them is transferred to the buyer at such times as the parties to the contract intend it to be transferred. The intention of the parties is ascertained from the terms of the contract, the conduct of the parties and the circumstances of the case. Unless a contrary intention appears, the undermentioned rules are applicable for ascertaining the intention of the parties (Secs.20-24).

1. ***Specific goods in a deliverable state.*** In the case of specific goods in a deliverable state, the property passes at the time the contract (unconditional) is made (Sec.20). The fact that the time of payment or the delivery of the goods or both are postponed does not affect the passing of the property. Sec.2(3) states that goods are said to be in a deliverable state when they are in such a state that the buyer would under the contract be bound to take delivery of them.
2. ***Specific goods not in a deliverable state.*** In the case of specific goods to which something has to be done by the seller to put them in a deliverable state, property passes only when such thing is done and the buyer has notice thereof (Sec.21).

Unascertained or future goods. When there is a contract for the sale of unascertained goods, property in the goods is not transferred to the buyer unless and until the goods are ascertained (Sec.18).

Sec.23 provides that in the case of sale of unascertained goods or future goods by description, property passes to the buyer when goods of that description in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller.

Notes

Unconditional appropriation. The unconditional appropriation of goods may be made either by the seller with the buyer's assent or by the buyer with the seller's assent. Normally goods shall be appropriated by the seller. Where he appropriates the goods to the contract, the property shall pass to the buyer only when the latter has assented to the appropriation. The assent, however, may be given before or after appropriation. Whether the appropriation is done by the seller or the buyer, the assent of the other party must be obtained. Where goods are in the possession of the buyer, he may do the appropriation.

Case Study

Sale of Goods Law

The case under consideration today concerns Susan, who is a self-employed painter and decorator and a painting firm known as "Paintplus". Susan had bought a cottage in a coastal area and had sought help from an assistant at the Paintplus store in recommending a heavy duty masonry paint that would withstand the harsh climate changes evident on a coastal area; and a brand of wipe-clean paint that would be suitable for interior use in a wet area (the bathroom). The assistant at Paintplus recommended their own brand of masonry paint (Everlast) because it was the cheapest available. Susan checked the description on the tin and agreed that the paint appeared to be suited to her requirements.

When asked about the bathroom paint the sales assistant told Susan that internal paints were not his speciality, but he had heard other customers comment favourably about a product known as "Cleaneasy". The store had some tins of Cleaneasy going at half price because the written description about the product had become detached from the tins some time previously so the tins were being sold without this documentation. Susan did ask the sales assistant if there was anything that she should know about the paint that might have been written on the leaflet and the sales assistant said, [quote] "its standard paint so just slap it on".

Over time Susan had problems with both paint types she had purchased from Paintplus. The masonry paint was easy to apply and withstood the harsh climate of winter, but over the summer months the temperatures were "unprecedented" and the paint started peel from the walls. The render under the paint was damaged through this and Susan had to employ a building professional to knock of the remaining render and paint, and then rerender and repaint the entire outside of the cottage.

Susan did not have much luck with the Cleaneasy paint either. While she was applying the paint some of it dropped on her skin and she suffered an allergic reaction to the paint. She needed medical treatment and was off work for three weeks because of this reaction. She also lost a major decorating contract because of her illness. Later investigations about the description that should have been on the tin when she bought it declared that if [quote] "any person suffering from skin complaints or sensitivities should refrain from using this product".

The first question considered in this paper is whether or not Susan could claim a breach of contract against Paintplus, and if so, on what grounds. Briefly a contract can be said to occur when an offer is made to one party, by another, and that offer is accepted. Having goods for sale in a shop is not considered an offer as such, but rather an invitation to treat although a bilateral contract can be said to occur in that the buyer agrees to pay a certain price for goods, which the seller promises to deliver. The essential parts of a contract include the offer and acceptance, the consideration elements of the contract (seller gets the money, buyer gets the paint) , the acceptance that the contract concerned a business rather

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than social or domestic matter , capacity (both parties had to be able to enter a contractual agreement), and the contract has to be based on a legal transaction (legality).

In the case between Susan and Paintplus there is no dispute that a contract was entered into because she visited the shop of her own volition, discussed different paint types with the sales assistant, and then based on the advice she had asked for and was given, purchased both the masonry and bathroom paint. She apparently paid for the goods and took them from the store, thereby completing the basic elements of the contract.

The case for a breach of contract in this situation relates to the Sale of Goods Act 1979 which applies to the concept of sales made in the course of a business and where goods are sold by a merchant that relate to the nature of the merchant's business. In particular s14(2) makes the distinction between goods that can be considered a private sale and those that are made in the course of doing business. It could be considered that in one respect Susan was purchasing the paint for a personal project, despite the nature of her occupation, because it was for a house that she had purchased. However s14(2) relates to the sellers business, not the buyers.

From there it is necessary to consider if the Susan was entitled to claim a breach of contract under the Sale of Goods Act 1979 or related legislation such as the Unfair Contract Terms Act 1977, s12. Section s12(1) states; "A party to a contract 'deals as consumer' in relation to another party if (a) he neither makes the contract in the course of a business nor holds himself out as doing so; and (b) the other party does make the contract in the course of a business". The case of R&B Customs Brokers v United Dominion Trust applies here because although Susan was herself a painter and decorator she bought the goods from Paintplus as a consumer, not as part of her business. It can be argued that this is the case because firstly Susan was buying the goods as a consumer to do work on her own property. Even though she may plan to rent the property out at a later stage, renting property cannot be considered her normal occupation and therefore Susan's future plans for the property are negliable in this case. The second indicator of Susan's position as a consumer stems from her asking advice from the sales assistant at Paintplus because she herself was not knowledgeable about paints that were suitable for masonry at a coastal area, nor interior paints that were suitable for a wet room such as a bathroom.

MacDonald noted that there have been other cases since R&B Customs Brokers and a precedent case Stevenson v Rogers that provide more latitude in the definition of "consumer sales" and "in the course of a business" especially when s14(2) of the Sale of Goods Act 1979 is considered alongside s12 of the Unfair Contract Terms Act 1977. She notes that there is a difference is phraseology that shows a subtle distinction between the phrase "in the course of a business" and the phrase "in the course of business" and cites Kidner as holding that the second phrase "suggests things done by and for a business".

A final consideration in the first part of this paper concerns Susan's inspection of the goods while she was at the paint store. Firstly in relation to the masonry paint, Susan did read the description of the product listed on the tin, and therefore would reasonably expect the products she bought to adhere to the description provided. Likewise it can be assumed that the tin's description did include enough information about the paint's use under different weather conditions for Susan to have purchased the paint without further questioning of the sales assistant. It can be argued therefore that in the case of the masonry paint, the paint did not meet the reasonable expectations of the purchaser and therefore Susan could claim breach of contract in connection with the masonry paint.

In the second instance, regarding the illness Susan sustained when using the bathroom paint, initially the description of the product was not present on the can although Susan did ask the sales assistant about any information about the paint that she should know

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before using it. The sales assistant said that there was nothing she need to be worried about, although a later investigation showed that the description that should have been on the can did mention that "any person suffering from skin complaints or sensitivities should refrain from using this product." The case study notes do not indicate if Susan had prior experience with being allergic to certain paints, and we can assume that she didn't because she was an experienced painter and decorator and would think to ask the sales assistant specifically about this matter if she had experienced problems before.

Whether or not Susan could claim breach of contract in the case of the bathroom paint would depend on whether the sales assistant could be considered liable because he did not mention that the paint had a health warning notice, but as s14(2) of the Sales of Goods Act 1979 states that goods do not need to be examined at the point of sale (by the buyer) and that a protection against faulty goods is allowable even if Susan had read the description of the paint used in the bathroom before she bought it. Therefore it can be argued that in both the masonry paint and the bathroom paint that Susan can claim breach of contract. In the case of the masonry paint the case would be based on the "reasonable expectation" Susan had that the paint would do what she required of it and in the case of the bathroom paint Susan can claim damages because the terms of the sale between buyer and seller could not be considered equitable in light of the illness she suffered as a result of the transaction and the money she lost for the jobs she could not do for three weeks while she was recovering from her allergic reaction.

The second part of this paper deals with whether or not Paintplus can argue any of the statements made on the back of their receipts or on the door of their building as defence in a breach of contract case. These statements are made as follows:

1. Paintplus agree to refund the purchase price of any products that fail to meet satisfactory standards of quality or fail to comply with any written description applied to the goods.
2. Subject to clause 1 above, Paintplus undertake no liability for damage however caused by any product that fails to meet satisfactory standards of quality or fail to comply with any written description applied to the goods.
3. Paintplus undertake no liability as to fitness for any specified purpose of the goods sold.
4. Paintplus undertakes no liability for advice given by Paintplus employees.

Items one and two of this terms of business agreement indicate that the company is prepared to refund the cost of the goods bought if they have proven to be defective in some way, or that they do not meet the standards described on the tin. However, they disclaim liability for any damage caused through the use of the goods. The Sale of Goods Act 1979 s15 indicate that a buyer is entitled to discharge a contract regardless of how slight the damage, or sellers breach may be but the same act does not consider liability in such clear cut terms. Undoubtedly if the clauses described in Paintplus's terms of business are contrary to legislation in the Sale of Goods Act 1979, then the courts will take the side of the applicable legislation as opposed to Paintplus's own efforts to disclaim liability, but whether this extends to forcing the company to pay out on damages as well as simple refund of costs incurred through the original purchase will be examined later in this paper. There is a precedent that relates to clauses in a contract that states if a clause in a contract (such as those outlined by Paintplus on their receipt and on the door of their premises) is ambiguous or vague then the courts will find for the innocent party and indeed some legislation does set a precedent for the insistence on the payment of damages in some cases.

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Item 3 concerns the fitness of a product for a specific purpose. In one case, Griffiths v Conway Ltd., 1939 a coat purchased from the claimant that caused dermatitis to be suffered by the buyer, the case was voided because the claimant had not told the seller about a known skin condition. This harks back to whether or not Susan had experienced allergies before when using certain types of paint. If she had done so then under law the onus would have been on her to disclose this to the sales assistant so that this issue could be resolved before the contract was completed. In regards to the masonry paint if the goods are specific, the risk for use is passed on to the buyer, but the buyer can still claim breach under the Unfair Contract Terms Act 1977.

Finally under item 4 of Paintplus's terms of business agreement the company attempts to refuse liability for the actions of a staff member. It can be argued in the case of the masonry paint that as the staff member had made the recommendation of the type of paint based on his own expertise on that topic (which can be implied by the sales assistant disclaiming expertise over the internal paint) and that he was employed specifically to sell products for which a limited amount of knowledge at least would be required; combined with the concept that the terms of business agreement made by Paintplus itself is binding on the staff, that they would not be able to dismiss liability for the masonry paint at least. The defendant could argue however in the case of the bathroom interior paint that because the sales assistant did specify that he was not an expert on that type of paint, that Susan did have the opportunity to ask to be directed to another sales person who was better qualified to make the sale of interior paint. Likewise she could have asked to see the written description of the product that she did buy, even if it was not included as part of the sale. However, from Susan's point of view she could argue that there was a reasonable expectation that the sales assistant knew his job and would have referred Susan to another sales person if he was not comfortable in recommending products that may or may not have met with Susan's expectations of the product or her needs related to the product.

Definitely it can be assumed that Susan had a reasonable expectation that the salesperson she dealt with was trained on paint types and was able to offer applicable advice and recommendations based on client needs because she did visit a specialist paint shop. This same argument might not be applicable if she had visited a non-specialist shop for her paint such as a second hand vendor.

The final part of this paper deals with the possible remedies available to Susan if her breach of contract claim was successful. Section 55(1) of the Sale of Goods Act allows for the negating or variance of a "right duty or liability" that is applicable to Susan in that she can claim a remedy regardless of the fact that the contract was completed. Under general terms however such remedy is often limited to a rejection of the goods (which is not strictly applicable in this case but could support any claim for a refund of price paid); or a claim for damages that is often limited simply to the difference between the price of goods that could have met the buyers expectations and the actual goods that were purchased.

There is provision under the Sale of Goods Act 1979 to award "specific performance", but this is a discretionary element and not often awarded by the courts . For example s52(1) limits specific performance to "specific" or "ascertained" goods, but again this is determined at the courts discretion relating to the specific case and elements thereof. There is no guarantee even if the buyer was harmed or went through significant hardship because of the goods purchased that any claim for damages beyond the refund price of the goods could be claimed. A second concern related to the laws surrounding remedies is that there is a dissention as to whether or not the Sale of Goods Act 1979 can be considered a codification of common law regarding sales law, or if the Sale of Goods Act could be applied in addition to those remedies considered under common law.

One final point needs to be made in this case and it is in respect to the bathroom paint that Susan purchased from Paintplus. Under section 53 if a buyer has accepted a lower price

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for goods (the bathroom paint was at half price because the labels had been removed) this can be considered a remedy of a breach of contract and therefore negate any future claim on other losses suffered by the buyer (such as her painting and decorating contract). In this case then it is fair to surmise that Susan would not be able to claim any damages in relation to the bathroom paint.

The question of damages in relation to the masonry paint (the rerendering and repainting of the building) Susan could attempt to claim damages from Paintplus but unless the Courts decided that the goods used were both "specific" or "ascertained" and therefore damages could be claimed, the amount awarded (if any) will be solely at the courts discretion.

Question

Analyse the case and Relate case with sales of good acts.

12.7 Summary

- A contract of sale is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. Sale is to be distinguished from an agreement to sell.
- Where under a contract of sale, the property in goods is transferred from the seller to the buyer, it is a called a sale.
- An agreement to sell means a contract of sale under which the transfer of property in goods is to take place at a future date or subject to conditions thereafter to be fulfilled.
- Goods may be classified as existing, future and contingent. In contract of sale, parties make certain stipulations.
- All stipulations are not treated on the same footing. These stipulations are technically known as conditions and warranties.

12.8 Keywords

Condition: A condition is a stipulation essential to the main purpose of the contact, the breach of which gives rise to a right to treat the contract as repudiated.

Contract of Sale: A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.

Delivery: It is defined as a voluntary transfer of possession from one person to another.

Ex-ship contracts: Under this agreement the seller has to deliver the goods to the buyer at the port of destination.

Goods: Goods mean every kind of movable property other than actionable claims and money.

12.9 Self Assessment

State whether the following statements are true or false:

1. No sale can take place without a price.
2. The delivery of ascertained goods is essential for the completion of sale.
3. Consideration in a contract of sale of goods can also be paid partly in money and partly in goods.
4. The right of lien by an unpaid seller can be exercised for the non-payment of price of goods and other charges.

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5. The word lien means to retain possession of.
6. The amount of damages is not to be determined in accordance with the provisions laid down in Sec.73 of the Indian Contract Act, 1872.
7. Risk follows ownership.
8. There are can be an 'agreement to sell' goods.
9. A 'Hire-purchase agreement' is a bailment plus an agreement to sell.

12.10 Review Questions

1. State the essentials of a contract of sale under the Sale of Goods Act, 1930.
2. Distinguish between (i) Sale and hire purchaser agreement. (ii) Sale and 'contract for work and labour'. (iii) sale and agreement to sell.
3. What is meant by goods?
4. What is meant by (i) ascertained and unascertained goods, (ii) specific and generic goods, (iii) existing and future goods?
5. What do you understand by a 'document of title to goods'? Give at least two examples of documents which are recognised by the Sale of Goods Act as being documents of title to goods.
6. What are the rules as given in the Sale of Goods Act, 1930, regarding fixation of price?
7. What do you understand by earnest money?

Answers: Self Assessment

1. True
2. False
3. True
4. False
5. True
6. False
7. True
8. True
9. False

12.11 Further Readings

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://www.dateyvs.com/gener12.htm

http://www.vakilno1.com/bareacts/saleofgoods/saleofgoods.htm

http://www.sudhirlaw.com/Business3.html

http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/whatwedo/consumers/fact-sheets/page38311.html

Unit 13: Transfer of Ownership

Notes

CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain transfer of title by non-owners and unpaid seller
- Discuss remedies of breach of contract

Introduction

In last unit you have studied about law of sales of goods. Indian business persons, conducting their business against the backdrop of the Sale of Goods Act, have not found it difficult to work out the several varieties of contracts of sale of goods as resorted to in national and transnational

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business, such as F.O.B. (free on board), C.I.F. (cost, insurance and freight) and ex-ship. This unit will give you a brief knowledge of transfer of title of non-owners.

'Goods' means every kind of movable property, other than actionable claims and money; and includes stocks and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

13.1 Transfer of Title by Non-owners

Sec.27 lays down a general rule as to transfer of title, that is, it is only the owner of goods who can transfer a good title. No one can give a better title than what he himself has. This rule is expressed by the maxim, 'memo dat quod non habet' which means that no one can give what he himself has not. If the seller, therefore, has no title, or he has defective title, the buyer's title will be equally wanting or defective, as the case may be, though he has purchased in good faith and for value.

Task Kaushal asks a dealer to supply him a shirt which not shrinks after use and wash. The dealer supplies a shirt which shrinks after use and wash. Kaushal can reject the shirt or keep the shirt and claim damage. Suggest.

Note Transfer of Title by Non-owners contained Secs. 27-30.

13.2 Performance of a Contract of Sale of Goods

The contract of sale of goods is to be performed. In this context, Secs.31-44 provide for the duties of the seller and the buyer and the rules regarding delivery of goods.

13.2.1 Duties of the Seller and the Buyer

It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale (Sec.31). However, no delivery need be given, if the buyer is not willing to pay the price, nor need the buyer pay the price, unless the seller is ready and willing to give delivery, as unless otherwise agreed, delivery and payment of price are concurrent conditions (Sec.32).

The seller has the duty of giving delivery of goods according to the (i) terms of the contract, and (ii) rules contained in the Act. The buyer of the goods has the duty to pay for the goods, accept delivery and pay compensation to the seller in case he wrongfully refuses to accept delivery.

13.2.2 Delivery

Delivery is defined as a voluntary transfer of possession from one person to another [Sec.2(2)]. Sec.33 provides that delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf.

Notes

13.2.3 Passing of Property in Goods in the Case of Foreign Trade

There are certain terms which are used in the contract of sale of goods in foreign trade. These terms reflect a number of conditions which are either attached by the parties or by custom and practice of business people. The most usual of such contracts are: (i) Free on board (F.O.B.) or Free on Airport (F.O.A.) and (ii) Cost, Insurance and Freight (C.I.F.) and Ex-Ship.

13.3 Unpaid Seller and his Rights

A contract is comprised of reciprocal promises. In a contract of sale, if seller is under an obligation to deliver goods, buyer has to pay for it. In case buyer fails or refuses to pay, the seller, as unpaid seller, shall have certain rights.

13.3.1 Who is an Unpaid Seller?

A seller of goods is an unpaid seller when (i) the whole of the price has not been paid or tendered. (ii) a bill of exchange or other negotiable instrument has been received as conditional payment and the condition on which it was received has not been fulfilled by reason of the dishonour of the instrument or otherwise.

13.3.2 Rights of an Unpaid Seller

The rights of an unpaid seller may broadly be classified under two heads, namely: (i) Rights under the Secs.73-74 of the Indian Contract Act, 1872, i.e., to recover damages for breach of contract. (ii) Rights under the Sale of Goods Act, 1930: (a) rights against the goods; (b) rights against the buyer personally. The rights against the goods are as follows:

13.3.3 Lien on Goods (Secs. 47-49)

The word lien means to retain possession of. An unpaid seller who is in possession of goods is entitled to retain them in his possession until payment or tender of the price in three situations, namely, (a) where the goods have been sold without any stipulation as to credit; (b) where the goods have been sold on credit, but the term of credit has expired; (c) where the buyer becomes insolvent. Lien can be exercised only for non-payment of the price and not for any other charges due against the buyer.

Example: The seller cannot claim lien for godown charges for storing the goods in exercise of his lien for the price.

13.3.4 Right of Stoppage in Transit

This right of the unpaid seller consists in preventing the goods from being delivered to the buyer and resuming and regaining their possession while in transit, retaining them till the price is paid. The right of stoppage in transit is earned only where the right of lien is lost and is available only where the buyer has become insolvent (Sec.50).

Examples: (i) Badal at Delhi orders goods of Anand at Calcutta. Anand consigns and forwards the goods to Badal. On arrival at Delhi, goods are taken to Badal's warehouse and left there. Badal refuses to take the goods and stop payment. The goods are deemed to be in transit and the unpaid seller can take them back.

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(ii) The goods are delivered on board the ship belonging to the buyer. Under the bill of lading the goods are deliverable to the buyer or his agents. Such a bill of lading is a delivery to the buyer and therefore, there could be no right of stoppage in transit.

13.3.5 Right of Resale (Sec.54)

The unpaid seller, who has retained the possession of the goods in exercise of his right of lien or who has resumed possession from the carrier upon insolvency of the buyer, can resell the goods, (i) if the goods are of a perishable nature, without any notice to the buyer and (ii) in other cases after notice to buyer calling upon him to pay or tender the price within a reasonable time and upon failure of the buyer to do so.

13.4 Remedies for Breach of a Contract

In addition to the rights of a seller against goods provided in Secs.47 to 54, the seller has the following remedies against the buyer personally. (i) suit for price (Sec.55); (ii) damages for non-acceptance of goods (Sec.56); (iii) suit for interest (Sec.56).

13.4.1 Suit for Price (Sec.55)

Where under a contract of sale the property in the goods has passed to the buyer and the buyer wrongfully neglects or refuses to pay the price, the seller can sue the buyer for the price of the goods. Where the property in goods has not passed to the buyer, as a rule, the seller cannot file a suit for the price; his only remedy is to claim damages.

Example: A sold certain goods to B for ₹ 5,000 and the price was agreed to be paid before the expiry of ten days of the contract. B fails to pay the price within the stipulated time. A can file a suit for price against B even though the goods have not been delivered or the property in goods has not been passed to B.

13.4.2 Suit for Damages for Non-acceptance (Sec.56)

Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. Where the property in the goods has not passed to the buyer and the price was not payable without passing of property, the seller can only sue for damages and not for the price. The amount of damages is to be determined in accordance with the provisions laid down in Sec.73 of the Indian Contract Act, 1872. Thus, where there is an available market for the goods prima facie, the difference between the market price and the contract price can be recovered.

13.4.3 Suit for Interest (Sec.61)

When under a contract of sale, the seller tenders the goods to the buyer and the buyer wrongfully refuses or neglects to accept and pay the price, the seller has a further right to claim interest on the amount of the price. In the absence of a contract to the contrary, the court may award interest at such rate as it thinks fit on the amount of the price. The interest may be calculated from the date of the tender of the goods or from the date on which the price was payable. It is obvious that the unpaid seller can claim interest only when he can recover the price, i.e., if the seller's remedy is to claim damages only, then he cannot claim interest.

13.4.4 Buyer's Remedies against Seller

Notes

The buyer has the following rights against the seller for breach of contract: (i) damages for non-delivery (Sec.57); (ii) right of recovery of the price; (iii) specific performance (Sec.58); (iv) suit for breach of condition; (v) suit for breach of warranty (Sec.59); (vi) anticipatory breach (Sec.60); (vii) recovery of interest (Sec.61).

13.5 Sale by Auction (Sec.64)

In the case of sale by auction the following rules apply:

1. When the goods are put up for sale in lots, each lot is deemed prima facie, to be the subject matter of a separate contract of sale.
2. At an auction, the sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner; until such completion any bidder may withdraw his bid. It is also the practice to say 'three times'.
3. A right to bid may be reserved expressly by or on behalf of the seller and where such right is expressly reserved but not otherwise, the seller or any person on his behalf may bid at the auction.
4. Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid for himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person. Any sale contravening this rule shall be treated as fraudulent.
5. The sale may be notified to be subject to a reserved or upset price.
6. If the seller makes use of pretended bidding to raise the price, sale is voidable at the option of the buyer.

Task When the sale complete in sale by auction process? Suggest.

13.6 Summary

- These conditions and warranties may be express or implied. Thus, sale takes place when there is a transfer of ownership in goods from the seller to the buyer.
- A sale is an executed contract.
- The term seller includes any person who is in the position of a seller, e.g., an agent of the seller, to whom a bill of lading has been endorsed, or a consignee or agent who has paid for the goods or is responsible for the price (s.45).
- The word lien means to retain possession of.
- No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

13.7 Keywords

Implied conditions and warranties: These are deemed to be incorporated by law in every contract of sale of goods unless the terms of the contract show a contrary intention.

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Lien means to retain possession.

Unpaid seller: A person who is in possession of goods is entitled to retain them in his possession until payment.

Warranty: A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated.

13.8 Self Assessment

Fill in the blanks:

1. Conditions and warranties are said to the …… when the terms of the contract expressly, provide for them
2. The …… is a fundamental principle of the law of sale of goods.
3. The …… of goods refers to the custody of goods.
4. …… lay down the rules which determine when property passes from the seller to the buyer.
5. …… lays down a general rule as to transfer of title.
6. …… is defined as a voluntary transfer of possession from one person to another.
7. …… provide for the duties of the seller and the buyer.

13.9 Review Questions

1. When may a seller give a better title to the buyer than he himself has in the goods sold? or 'No one can give what he himself has not'. Elucidate.
2. Explain the rules relating to delivery of goods.
3. What is (i) an F.O.B. contract. (ii) a C.I.F. contract?
4. Define an unpaid seller. What are the different rights of an unpaid seller?
5. Distinguish between the right of lien and stoppage in transit.
6. State the circumstances when the right of stoppage in transit ends.
7. When can a seller resell the goods?
8. What remedies are available to a seller for breach of contract of sale?
9. Discuss the buyer's remedies against seller where there is a breach of contract.
10. State the law which governs the sale of goods by auction.

Answers: Self Assessment

1. Express
2. Doctrine of caveat emptor
3. Possession
4. Delivery
5. Sec.27
6. Secs.31-44
7. Secs.18 to 25

13.10 Further Readings

Notes

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi.

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi.

Online links

http://www.dateyvs.com/gener12.htm

http://www.vakilno1.com/bareacts/saleofgoods/saleofgoods.htm

http://www.sudhirlaw.com/Business3.html

http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/whatwedo/consumers/fact-sheets/page38311.html

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Unit 14: Law of Negotiable Instruments

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Objectives

After studying this unit, you will be able to:

- Discuss meaning of negotiable instrument
- Explain promissory notes and features of promissory note
- Describe law relating to paying and collector banker
- Discuss bill of exchange

Introduction

In the earlier unit, you came to know about the law of sales of goods. In this unit, you will study about the law of negotiable instruments.

In this unit, you will study law relating to negotiable instruments is primarily contained in the Negotiable Instruments Act, 1881, which came into force on 1st March, 1882. Bills of exchange, cheques and promissory notes have been dealt with in considerable detail in this Act.

The term 'instrument' means 'any written document by which a right is created in favour of some person'. The word 'negotiable' has a technical meaning whereby rights in an instrument can be transferred by one person to another.

14.1 Negotiable Instrument

An 'Instrument' as referred to in the Act is a legally recognised written document, whereby rights are created in favour of one and obligations are created on the part of another. The word 'negotiable' means transferable from one person to another either by mere delivery or by endorsement and delivery, to enable the transferee to get a title in the instrument. An instrument may possess the characteristics of negotiability either by statute or by usage. Promissory note, bill of exchange and cheque are negotiable instruments by statute as they are so recognised by Sec.13. There are certain instruments which are recognised as negotiable instruments by usage. Thus, bank notes, bank drafts, share warrants, bearer debentures, dividend warrants, scripts and treasury bills are negotiable by usage. An instrument is called 'negotiable' if it possesses the following features:

1. ***Freely transferable.*** Transferability may be by (a) delivery, or (b) by endorsement and delivery.
2. ***Holder's title free from defects.*** The term 'negotiability' means that not only is the instrument transferable by endorsement and/or delivery, but that its holder in due course acquires a good title notwithstanding any defects in a previous holder's title. A holder in due course is one who receives the instrument for value and without any notice as to the defect in the title of the transferor.

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3. ***The holder can sue in his own name.*** Another feature of a negotiable instrument is that its holder in due course can sue on the instrument in his own name.
4. A negotiable instrument can be transferred infinitum, i.e., can be transferred any number of times, till its maturity.
5. ***A negotiable instrument is subject to certain presumptions.*** An instrument, which does not have these characteristics, is not negotiable, but is assignable, i.e., the transferee takes it subject to all equities and liabilities of the transferor.

14.2 Important Terms and Essential of Negotiable Instrument

14.2.1 Ambiguous Instrument (Sec.17)

An ambiguous instrument is one which may be construed either as a promissory note or as a bill of exchange. Regarding such instruments, Sec.17 provides that the holder may, at this election treat it as either and the instrument shall be thenceforward treated accordingly. Thus, a bill of exchange drawn by a person upon himself may be construed as a promissory note.

14.2.2 Inchoate Stamped Instruments (Sec.20)

An inchoate instrument means an instrument that is incomplete in certain respects. Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein but not exceeding the amount covered by the stamp.

14.2.3 Capacity of Parties to the Negotiable Instrument

The capacity of a party to draw, accept, make or endorse a negotiable instrument is coextensive with his capacity to enter into contract. Thus, Sec.11 of the Indian Contract Act, 1872, if negatively interpreted prohibits minors, persons of unsound mind and persons forbidden under any other Act like insolvency to make a valid contract.

14.2.4 Essential Elements of a Negotiable Instrument

After discussing the characteristics of different negotiable instruments, it is with profit that we can sum up the essential elements of a negotiable instrument. These are as follows:

1. It must be in writing, which includes, typing, computer print out or engraving.
2. The instrument must be signed by the person who is the maker (in the case of a promissory note) or a drawer (as in the case of a bill of exchange or a cheque).
3. There must be an unconditional promise (as in the case of a promissory note) or order (as in the case of a bill of exchange or cheque) to pay.
4. The instrument must involve payment of a certain sum of money only and nothing else.
5. The instrument must be payable at a time which is certain to arrive. If it is payable 'when convenient' the instrument is not a negotiable one. However, if the time of payment is linked to the death of a person, it is nevertheless a negotiable instrument as death is certain, though the time thereof is not.
6. In case of a bill or cheque, the Drawee must be named or described with reasonable certainty.

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7. The instrument must be such or in such a state that it can be transferred like cash by mere delivery (as in the case of a bearer instrument) or by delivery and endorsement (as in the case of an order instrument).

14.3 Promissory Notes and Bills of Exchange

14.3.1 Promissory Note

A promissory note is an instrument in writing (not being a bank or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person or to the bearer of the instrument (Sec.4). The following are two illustrations of promissory notes.

Example: "We have received a sum of ₹ 9,000 from Shri R.R. Sharma. This amount will be repaid on demand. We have received this amount in cash." This is a promissory note.

Where A signs instruments in the following terms: (i) "I promise to pay B or order ₹ 500." (ii) "I acknowledge myself to be indebted to B in ₹ 1000, to be paid on demand, for value received."

But, the following are NOT promissory notes: (i) "Mr B, I.O.U. (I owe you) ₹ 1000." (ii) "I am liable to pay you ₹ 500". (iii) "I promise to pay B ₹ 500 and all other sums which shall be due to him." (iv) "I promise to pay B ₹ 500, first deducting thereout any money which he may owe me." (v) "I promise to pay B ₹ 1500 on D's death, provided he leaves me enough to pay that sum." (vi) "I promise to pay B ₹ 500 seven days after my marriage with C." (vii) "I promise to pay B ₹ 500 and to deliver to him my white Maruti Car 1 January next."

Example: A promises to pay B ₹ 500 provided C leaves sufficient money in favour of A after C's death. It is not a promissory note.

Note

Specimen of a Promissory Note

₹ 10,000 New Delhi – 1100 01

Jan. 10, 2006

On demand [or six months after date] I promise to pay X or order the sum of rupees ten thousand with interest at 12 per cent per annum only for value received.

To X Sd/-A

Address……. Stamp

Parties to a Promissory Note

1. ***Maker:*** The person who makes the note promising to pay the amount stated therein.
2. ***Payee:*** The person to whom the amount of the note is payable.
3. ***Holder:*** It is either the original payee or any other person in whose favour the note has been endorsed.
4. ***Endorser:*** The person who endorses the note in favour of another person.
5. ***Endorsee:*** The person in whose favour the note is negotiated by indorsement.

Notes

14.3.2 Bill of Exchange

A 'bill of exchange' is defined by Sec.5 as 'an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of, a certain person, or to the bearer of the instrument'.

Note **Specimen of a Bill of Exchange**

₹ 10,000 New Delhi – 110 016

Jan. 13, 2006

Six months after date pay to A or order/bearer the sum of ten thousand rupees only for value received.

To X Sd/-A

Address……. Stamp

Here Y is the drawer, A is the payee and X is the drawee. X will express his willingness to pay 'accepting' the bill by writing words somewhat as below across the face of the bill:

ACCEPTED

Sd-X Jan. 16, 2006.

The specimen given above is of a usance bill, payable after a specified period of time. A bill of exchange may be drawn payable 'at sight', i.e., on demand or payable 'after certain time after sight' also.

Note There are only two parties – the maker (debtor) and the payee (creditor) in promissory note, and there are three parties – the drawer, the drawee and the payee although drawer and payee may be the same person in bill of exchange.

Parties to a Bill of Exchange

The parties of bill of exchange are:

1. ***Drawer:*** The person to whom the amount of the bill is payable.
2. ***Drawee:*** The person on whom the bill is drawn. Thus, drawee is the person responsible for acceptance and payment of the bill. In certain cases however a stranger may accept the bill on behalf of the drawee.
3. ***Payee:*** The person to whom amount of the bill is payable. It may be the drawer himself or any other person.
4. ***Holder:*** It is the original payee but where the bill has been endorsed, the endorsee. In case of a bearer bill, the bearer or possessor is the holder.
5. ***Endorser:*** It is the person who endorses a bill.
6. ***Endorsee:*** It is the person to whom the bill is negotiated by endorsement.
7. Drawee in case of need.
8. Acceptor for honour.

Notes

14.3.3 Distinction between a Promissory Note and a Bill of Exchange

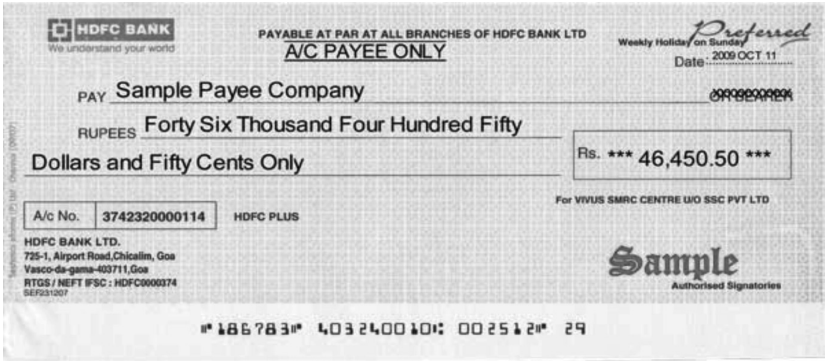
	Promissory Note	Bill of Exchange
1.	There are only two parties – the maker (debtor) and the payee (creditor).	There are three parties – the drawer, the drawee and the payee although drawer and payee may be the same person.
2.	A note contains an unconditional promise by the maker to pay the payee.	It contains an unconditional order to the drawee to pay according to the drawer's directions.
3.	No prior acceptance is needed.	A bill payable 'after sight' must be accepted by the drawee or his agent before it is presented for payment.
4.	The liability of the maker or drawer is primary and absolute.	The liability of the drawer is secondary and conditional upon non-payment by the drawee.
5.	No notice of dishonour need be given.	Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.
6.	The maker of the note stands in immediate relation with the payee.	The maker or drawer does not stand in immediate relation with the acceptor or drawee.

14.4 Cheques

A cheque is the usual method of withdrawing money from a current account with a banker. Savings bank accounts are also permitted to be operated by cheques provided certain minimum balance is maintained. A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, to or to the order of the person named therein or to the bearer. Sec.6 defines a cheque. The Amendment Act 2002 has substituted new section for Sec.6. It provides that a 'cheque' is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic from.

'A cheque in the electronic form' means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature and asymmetric crypto system.

14.4.1 Specimen of a Cheque



Every bank has its own printed cheque forms which are supplied to the account holders at the time of opening the account as well as subsequently whenever needed. These forms are printed on special security paper which is sensitive to chemicals and makes any chemical alterations noticeable. Although, legally, a customer may withdraw his money even by writing his directions to the banker on a plain paper but in practice bankers honour only those orders which are issued on the printed forms of cheques.

Notes

14.4.2 Requisites of a Cheque

The requisites of cheques are:

1. ***Written instrument.*** A cheque must be an instrument in writing. Regarding the writing materials to be used, law does not lay down any restrictions and therefore cheque may be written either with (a) pen (b) typewriter or may be (c) printed.
2. ***Unconditional order.*** A cheque must contain an unconditional order. It is, however, not necessary that the word order or its equivalent must be used to make the document a cheque., Generally, the order to bank is expressed by the word "pay". If the word "please" precedes "pay" the document will not be regarded as invalid merely on this account.
3. ***On a specified banker only.*** A cheque must be drawn on a specified banker. To avoid any mistake, the name and address of the banker should be specified.
4. ***A certain sum of money.*** The order must be only for the payment of money and that too must be specified. Thus, orders asking the banker to deliver securities or certain other things cannot be regarded as cheques. Similarly, an order asking the banker to pay a specified amount with interest, the rate of interest not specified, is not a cheque as the sum payable is not certain.
5. ***Payee to be certain.*** A cheque to be valid must be payable to a certain person. 'Person' should not be understood in a limited sense including only human beings. The term in fact includes 'legal persons' also. Thus, instruments drawn in favour of a body corporate, local authorities, clubs, institutions, etc., are valid instruments being payable to legal persons.
6. ***Payable on demand.*** A cheque to be valid must be payable on demand and not otherwise. Use of the words 'on demand' or their equivalent is not necessary. When the drawer asks the banker to pay and does not specify the time for its payment, the instrument is payable on demand (Sec.19).
7. ***Dating of cheques.*** The drawer of a cheque is expected to date it before it leaves his hands. A cheque without a date is considered incomplete and is returned unpaid by the banks. The drawer can date a cheque with the date earlier or later than the date on which it is drawn. A cheque bearing an earlier date is antedated and the one bearing the later date is called post-dated. A post-dated cheque cannot be honoured, except at the personal risk of the bank's manager, till the date mentioned. A post-dated cheque is as much negotiable as a cheque for which payment is due, i.e., the transferee of a post-dated cheque, like that of the cheque on which payment is due, acquires a better title than its transferor, if he is a holder in due course. A cheque that bears a date earlier than six months is a stale cheque and cannot be claimed for.


Task Analyze the parties involved in bill of exchange.

14.5 Holder and Holder in due Course

According to Sec.8, a holder of negotiable instruments is "a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.

A 'holder in due course', on the other hand, is "a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or

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endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (Sec.9). Thus, where a person receives a negotiable instrument without consideration, he may be a holder but will not be called a holder in due course. Besides, the title of holder of a negotiable instrument is always subject to the title of its transferor whereas a holder in due course acquires a better title than that of its transferor. So where a lost negotiable instrument is transferred to a person who takes it, say, without consideration and thus becomes the holder, he will not be entitled to enforce his claim against its real owner. But, if he is a holder in due course as per Sec.9, he will be able to establish his claim even against the real owner of that instrument.

Privileges of a Holder in Due Course

A holder in due course is given certain additional privileges under the Act, which are not available to a holder.

1. ***Privilege against inchoate stamped instruments.*** According to Sec.20, a person, who signed and delivered to another a stamped but otherwise inchoate (incomplete) instrument, is stopped from asserting, as against a holder in due course, that the instrument has not been filled in accordance with the authority given by him provided the amount filled is covered by the stamp affixed.
2. As per Sec.3, every prior party to a negotiable instrument, i.e., the maker or drawer, the acceptor and all the intermediate endorsers continue to remain liable to the holder in due course until the instrument is duly satisfied.
3. ***Fictitious drawer or payee.*** Where a bill of exchange is drawn by a fictitious person and is payable to his order, the acceptor cannot be relieved from his liability to the holder in due course. The holder in due course shall, however, have to prove that the instrument was endorsed by the same hand as drawer's signature (Sec.42).
4. When a negotiable instrument is made, drawn accepted or transferred without consideration and the negotiable instrument gets into the hands of a holder in due course, then the plea of absence of consideration cannot be raised against him or against any subsequent holder deriving title from him (Sec.43).
5. Where an instrument is negotiated to a holder in due course, the parties to the instrument cannot escape liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sec.46).
6. ***Right of an endorsee from a holder in due course.*** Not only that the title of the holder in due course is not subject to the defect in previous holder's title but once that instrument passes through the hands of a holder in due course, it is purged of all defects. Any person acquiring it takes it free of all defects, unless he was himself a party to the fraud (Sec.53).

14.6 Negotiation of a Negotiable Instrument

14.6.1 Meaning of Negotiation

The transfer of an instrument by one party to another so as to constitute the transferee a holder thereof is called 'negotiation'.

14.6.2 Negotiation and Assignment

Both the assignment and negotiation involve the transfer of the right to receive the payment of debt. However, the rights, which the transferee of an instrument by negotiation acquires are

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substantially superior to those of an assignee. When an instrument is negotiated, its transferee gets good title irrespective of the defective title, if any, of the transferor.

Example: A, the holder of a negotiable instrument payable to bearer, delivers it to B's agent to keep for B. The instrument has been negotiated.

14.6.3 Endorsement

An endorsement is the mode of negotiating a negotiable instrument. A negotiable instrument payable otherwise than to bearer can be negotiated only by indorsement and delivery. An endorsement according to Sec.15, is "when the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same and is called the endorser". The person to whom the instrument is endorsed is called the endorsee. Usually the endorsement is on the back of the instrument; though it may be even on the face of it. Where no space is left on the instrument, the endorsement may be made on a slip of paper attached to it. This attached slip of paper is called 'Allonge'.

Example: A cheque is payable to '*X* or order', and '*X*' merely signs on the back of it. This will constitute endorsement in blank. Where an endorsement in blank is subsequently followed by an endorsement in full, the endorser in full will be liable to his immediate endorsee and parties deriving title from him, but not to others (s.55).

Example: A cheque is endorsed in blank by 'X'. Y, the holder of the cheque, may convert this 'blank endorsement' into 'endorsement in full' by say, adding the words 'Pay Z or order', above 'X's signature. Y, in this case cannot be held liable on the cheque, if it is dishonored.

14.6.4 Forged Endorsement (Sec.85)

In case an instrument is endorsed in full, it cannot be endorsed or negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable. Thus, if such an instrument is negotiated by way of a forged endorsement, the endorsee will acquire no title even though he be a purchaser for value and in good faith, because the endorsement is nullity. But where the instrument has been endorsed in blank, it can be negotiated by mere delivery and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.

Example: A bill is endorsed, "pay to X or order". X endorses it in blank and it comes into the hands of Y, who simply delivers it to A. A forges Y's endorsement and transfers it to B. B, as the holder, does not derive his title through the forged endorsement to Y, but through the genuine endorsement of X and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

14.7 Presentment

Presentment of a negotiable instrument is made for two purposes: (i) for acceptance and (ii) for payment.

Before discussing the presentment for payment, it is necessary to refer to the maturity of the instrument.

Notes

14.7.1 Maturity (Secs.21-25)

Cheques are always payable on demand but other instruments like bills, notes, etc., may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called maturity (Sec.22). Therefore most of the provisions relating to presentment for payment are linked with the maturity of the instrument. Sec.21 provides that a note or bill 'at sight' or 'on presentment' is payable on demand. It is due for payment as soon as it is issued. Therefore the question of maturity arises only in the case of a note or bill payable 'After sight' or 'After date' or at a certain period after the happening of an event which is certain to happen.

14.7.2 Presentment for Payment

A negotiable instrument must be presented for payment to the maker, acceptor or drawee thereof, as the case may be, by the holder or his agent. In case of default, the parties to the instrument other than the maker, acceptor or drawee are not liable to such holder (Sec.64). The presentment for payment must be made during the usual hours of business, and at a banker's premises, during banking hours (Sec.65).

Task Discuss the various effects of endorsement.

14.8 Dishonour

14.8.1 Dishonour of a Bill

A bill of exchange may be dishonoured either by non-acceptance or by non-payment. A negotiable instrument is said be dishonoured by non-payment when the maker, acceptor or drawee, as the case may be, makes default in payment upon being duly required to pay the same (Sec.92). The effect of dishonour of a negotiable instrument whether by non-acceptance or non-payment is to render the drawer and all the endorsers liable to the holder. However, their liability can be invoked only if the holder gives them notice of such dishonour. The drawer is liable only if the instrument is dishonoured by non-payment.

When a negotiable instrument is dishonoured by non-acceptance or non-payment, the holder must give notice of dishonour to the drawer and all other parties whom he seeks to make liable.

14.8.2 Noting

Noting is a convenient method of authenticating the fact of dishonour. Where an instrument is dishonoured, the holder, besides giving the notice as referred to above, should get the bill or promissory note 'noted' by the notary public. The notary public presents the instrument, notes down in his register the date of its dishonour and the reason, if any, given by the acceptor. If the instrument has been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary's charges should be mentioned. 'Noting' must be made within a reasonable time after dishonour. The holder may cause such dishonour to be noted by the notary public upon the instrument or upon a paper attached thereto or partly upon each (Sec.99). Every notary is required to have and use a seal, and an act can only be deemed a notarial act if it is done by a notary under his signature and official seal.

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14.8.3 Protesting (Sec.100)

The protest is the formal notarial certificate attesting the dishonour of the bill and based upon the noting. After the noting has been made, the formal protest may be drawn up by the notary at his leisure. When the protest is drawn up it relates back to the date of noting.

14.9 Crossing of Cheques

14.9.1 Meaning of Crossing

Crossing is a unique feature associated with a cheque affecting to a certain extent the obligation of the paying banker and also its negotiable character. It is a peculiar method of modifying the instrument to the banker for payment of the cheque. Crossing on cheque is a direction to the paying banker by the drawer that payment should not be made across the counter. The payment on a crossed cheque can be collected only through a banker. Sec.123 defines crossing as, "Where a cheque bears across its face an addition of the words 'and company' or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words, 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally." A cheque that is not crossed is a called an open cheque.

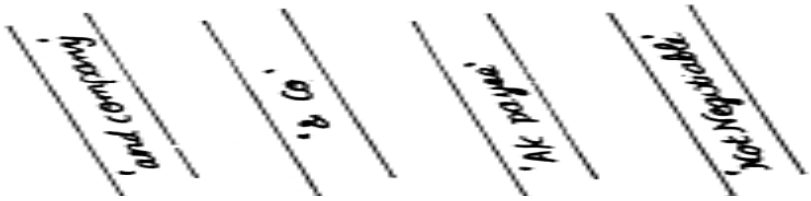
14.9.2 Significance of Crossing

As payment cannot be claimed across the counter on a crossed cheque, crossing of cheques serves as a measure of safety against theft or loss of cheques in transit. By crossing a cheque, a person, who is not entitled to receive its payment, is prevented from getting the cheque encashed at the counter of the paying banker.

14.9.3 Types of Crossing

Crossing may be either (1) General or (2) Special. The term general crossing implies the addition of two parallel transverse lines.

Note **Specimen of General Crossing**



'Special Crossing' implies the specification of the name of the banker on the face of the cheque. Sec.124 in this regard reads: "Where a cheque bears across its face, an addition of the name of banker, either with or without the words 'not negotiable', that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be paid to that banker". The drawing of two parallel lines is not necessary in case of a specially crossed cheque. The object of special crossing is to direct the drawee banker to pay the cheque only if it is presented through the particular bank mentioned therein. Thus, it makes the cheques more safer.

Specimen of Special Crossing

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14.10 Paying Banker

The 'paying banker' is a term used to denote the position and duties of the drawee-banks in paying the cheques of their customers. Thus, 'paying banker' is a banker upon whom a cheque is drawn.

Payment in due Course

What is a payment in due course is defined in Sec.10 and has been given above. The following conditions must be satisfied before a payment of a negotiable instrument can be called as a payment in due course:

1. Payment must be in accordance with the apparent tenor of the instrument. It is necessary that a payment to constitute a payment in due course should be made at or after maturity. A payment before maturity is not a payment in due course.

Example: Payment of a post dated cheque is not a payment in due course.

2. Payment must be made in good faith and without negligence. When there exists suspicious circumstances and the paying banker fails to make any enquiry as to them, the payment is not in due course. So payment is not in due course, where a banker makes payment on a cheque materially altered, without exercising due care.
3. Payment must be made to the person in possession of the instrument. A payment is not a payment in due course if it is made to a person entitled to receive it. A thief is not said to be in possession of the instrument.
4. Payment must be made under circumstances which do not afford a reasonable ground for believing that a person is not entitled to receive payment of the amount mentioned therein. So, where a peon of a company presents a cheque for a big amount on behalf of the company, which is contrary to the past experience, the banker should conduct proper enquiry before making payment on such a cheque.
5. Payment must be made in money only. Payment must be made in money only unless the payee agrees to accept payment in some other form (e.g., bill of exchange or promissory note). Money includes bank notes or currency notes but excludes cheque, bills of exchange, promissory notes and goods.

Thus, under Sec.10, payment in due course means payment in accordance with the apparent tenor of the instrument made in good faith and without negligence.

Task Consider the validity of the following documents as a promissory note: "I promise to pay P or bearer a sum of ₹ 5000 less charges involved in documentation of accounts' signed M.

Notes

Case Study

City Limouzines India Ltd.

Deepak is a client of City Limouzines India Ltd. He received a cheque of amount ₹ 6000 dated as 2-sep-2009 from City Limouzines India Ltd, & deposited same cheque on 7-Sep-2009 in his Bank, which has been bounced with narration "Insufficient Balance".

He called on City Limouzines India Ltd help line for same, but didn't get any satisfactory response from help line, He called on "Toll Free/24X7 Helpline: 23814792" at 2:16 PM on dated 12-Sep-2009 a lady picked the call and she didn't show any interest to resolve his query/concern, she hanged the phone with stating that "We will dispatch a letter after 20th Sep then check."

Deepak states that, as per his knowledge and as per company websites "City Limouzines" India Ltd. and ISO approved company. But I am unable to understand that how a cheque of amount ₹ 6000 get bounced with narration "Insufficient Balance"? I sent mail regarding same on given e mail ID "info@citylimouzines.com" but till date I am not getting any revert from company.

It is very serious case; if company is going to Fraud then it will impact all investors. Thinking this, he lodges a complaint the consumer court requesting them to take legal action against City Limouzines India Ltd.

Questions

1. Analyse the legal actions which should be taken by the Consumer court for the protection of Investors. (***Hint:*** recall consumer protection act again)
2. What penalties should be forced on the company? (***Hint:*** Refer 7.11 of this unit)
3. Every now & then, there are cases of cheque bouncing & dishonour. What precautions & remedies would you suggest for the investors to get them protection from such fraud companies? (***Hint:*** Refer 7.9 of this unit)

14.11 Summary

- The Negotiable Instrument Act, 1881 came into force on 1st March 1881. It extends to the whole of India except the State of Jammu & Kashmir.
- The term Negotiable Instrument consists of two parts viz.; Negotiable and Instrument.
- The word 'negotiable' means transferable by delivery and the word 'instrument ' mean written documents by which a right is created in favour of some person.
- It means an instrument possessing the quality of Negotiability is entitled to be called negotiable instrument.
- As per the instructions issued by the Reserve Bank of India (9-9-1992) it would be safer for the drawer to cross a cheque "not negotiable" with the words "account payee" added to it.
- The courts of law have held that "an account payee" crossing is a direction to the collecting banker as to how the proceeds are to be applied after receipt.
- The banker can disregard the direction only at his own risk and responsibility.

14.12 Keywords

Notes

Bill of exchange: A bill of exchange is an instrument in writing containing an unconditional to the order of a certain person or to the bearer of the instrument.

Cheque: A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable.

Endorsee: The person in whose favour the note is negotiated by endorsement.

Endorser: The person who endorses the note in favour of another person.

Holder: It is either the original payee or any other person in whose favour the note has been endorsed.

Negotiable Instrument: Means a promissory note, bill of exchange or cheque payable either to order or to bearer.

Payee: The person to whom the amount of the note is payable.

Promissory Note: A promissory note is an instrument in writing containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument.

Time bills: Also called as usance bills, are bills payable at a fixed period after date or sight of the bills.

14.13 Self Assessment

State whether the following statements are true or false:

1. A negotiable instrument need not be in writing
2. Signature of the maker is not required in the case of a promissory note
3. Bills in set are used in foreign trade transactions
4. It is not necessary to put any date in the case of promissory notes payable on demand.
5. A cheque must always be crossed to make it a valid instrument
6. One can get a post-dated cheque encashed across the bank counter at any time.
7. The life of a cheque is three months from the date of issue.
8. All types of bills are entitled for three days of grace.
9. A post dated cheque is valid and negotiable.
10. Maturity date is not required to be determined in the case of cheques.

Fill in the blanks:

11. …… is one who receives the instrument for value and without any notice as to the defect in the title of the transferor.
12. An …… is one which may be construed either as a promissory note or as a bill of exchange.
13. An inchoate instrument means an instrument that is …… in certain respects.
14. A …… is "a person who for consideration became the possessor of a promissory note, bill of exchange or cheque.
15. An …… is the mode of negotiating a negotiable instrument.

Notes

16. A negotiable instrument is said be …… by non-payment.
17. The …… is the formal notarial certificate attesting the dishonour of the bill and based upon the noting.
18. A cheque having the cross mark such as 'X' is not generally regarded as a …….
19. …… is a banker upon whom a cheque is drawn.

14.14 Review Questions

1. What do you mean by negotiable instruments?
2. Name the instruments which are recognized as negotiable instruments by the Negotiable Instruments Act, 1881.
3. What is a bill of exchange? Describe its characteristics. How does a promissory note differ from a bill of exchange?
4. "A cheque is a bill of exchange drawn on a banker". Comment
5. Define the term 'holder', 'holder for value' and 'holder in due course'.
6. What do you mean by negotiation? How it differs from assignment?
7. Explain the provisions relating to 'Noting' and 'Protesting' of a bill which has been dishonoured by the acceptor.
8. Describe briefly the meaning of 'general' and 'special' crossing and "crossing after the issue of a cheque".
9. "Issue of a cheque that bounces is an offence". Comment.
10. What are the provisions of the Negotiable Instruments Act, 1881, regard international law concerning negotiable instruments?

Answers: Self Assessment

1. False
2. False
3. True
4. True
5. False
6. False
7. False
8. False
9. True
10. False
11. A holder in due course
12. Ambiguous instrument
13. Incomplete
14. Holder in due course
15. Endorsement
16. Dishonoured
17. Protest
18. Paying banker
19. Crossed cheque

14.15 Further Readings

Notes

Books

G. Vijayaragavan Iyengar (2007), *Introduction to Banking*, Excel Books, New Delhi, India.

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Online links

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http://www.ebcwebstore.com/product_info.php?products_id=726

http://www.legalindia.in/the-negotiable-instruments-act-1881-2

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