Commercial Law

DCOM103

LOVELY
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COMMERCIAL LAW

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SYLLABUS

Commercial Law

Objectives: This course is aimed at teaching the laws within which any business in India is supposed to operate and which defines the nature and enforceability of business Transactions.

Sr. No.	Topics
1.	Definition and nature of contracts, classification of contracts, Offer and Acceptance, Consideration, free consent, Discharge of contract.
2.	Indemnity & Guarantee: Types, Rights and Duties, Difference between Contract of Indemnity and Guarantee.
3.	Bailment & Pledge: Types, Rights and Duties.
4.	Agency: Creation, Termination, Sub agent and Substituted Agent, Rights and Duties of agent.
5.	Contract of sales of goods: Sale and agreement to sell, conditions & warranties, Remedial Measures, Caveat Emptor.
6.	Consumer Protection Act, 1986: Definitions, Consumer Redressal Forums.

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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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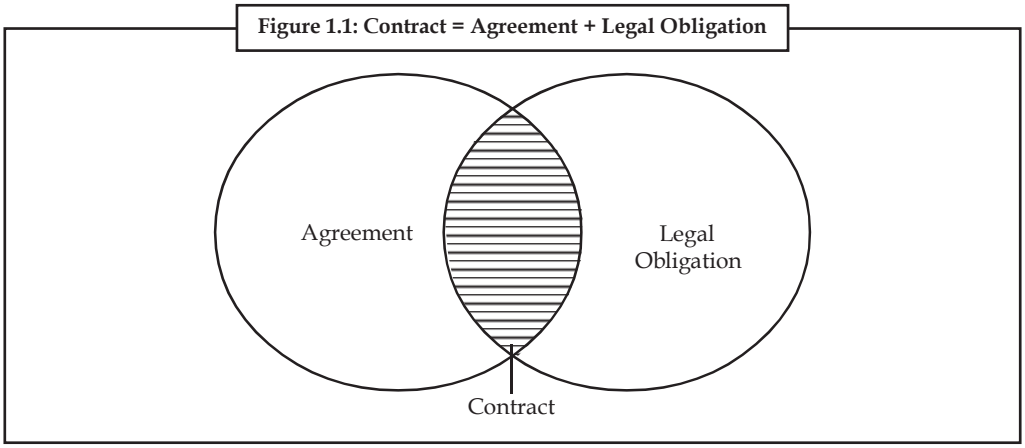
1.1 Agreement

Section 2(e) defines an agreement as "every promise and every set of promises forming consideration for each other". In this context, the word 'promise' is defined by S.2(b). In a contract there are at least two parties. One of them makes a proposal (or an offer) to the other, to do something, with a view to obtaining the assent of that other to such act. When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted becomes a promise [S.2(b)]. The person making the proposal is called 'promisor' and the person accepting the proposal is called the 'promisee' [S.2(c)].

Enforceability by law. The agreement must be such which is enforceable by law so as to become a contract. Thus, there are certain agreements which do not become contracts as this element of enforceability by law is absent. For example, an agreement to go for a stroll together or for a picnic does not become a contract, and therefore, neither rights nor obligations are created on the part of the parties to the agreement. Thus, all agreements are not contracts; but all contracts are agreements. Further all legal obligations are not contractual. Only those legal obligations which have their source in an agreement are contractual. Thus, a legal obligation not to create a nuisance for others does not give rise to a contract; but nevertheless it is actionable by law.

Figure 1.1: Contract = Agreement + Legal Obligation



Example: (i) A agrees to sell his motorcycle to B for ₹ 10,000. 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 ₹ 10,000 to A. The agreement is a contract. If A does not deliver the motorcycle, then B can go to a court of law and file a suit against A for non-performance of the promise on the part of A. On the other hand, if A has already given the delivery of the motorcycle and B refuses to pay the price, A can go to the court and file a suit against B for non-performance of promise.

(ii) A invites B for dinner in a restaurant. B accepts the invitation. On the appointed day, B goes to the restaurant. To his utter surprise A is not there or A is there but refuses to entertain B. B shall have no remedy against A. Similarly, in case A is present in the restaurant but B fails to turn up, then A shall have no remedy against B.

(iii) A gives a promise to his son to give him a pocket allowance of ₹ 150 every week. In case A fails or refuses to give the promised amount, his son has no remedy against A.

In examples (ii) and (iii) above, the promises are not enforceable by law as there was no intention to create legal obligation. Such agreements are social agreements which do not give rise to legal consequences. In example (i) the obligation has it source in an agreement and the parties intend to be bound by the same and therefore it gives rise to a contract.

Necessity of knowing as to what constitutes a contract. It is necessary for us to know as to what constitutes a contract as it is the key to understanding many legal questions. Very often a dispute

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centres not on whether someone has violated a contract but whether there was a contract in the first place. Other disputes centre on whether a change in circumstances has made the contract unenforceable.

1.2 Contract

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.

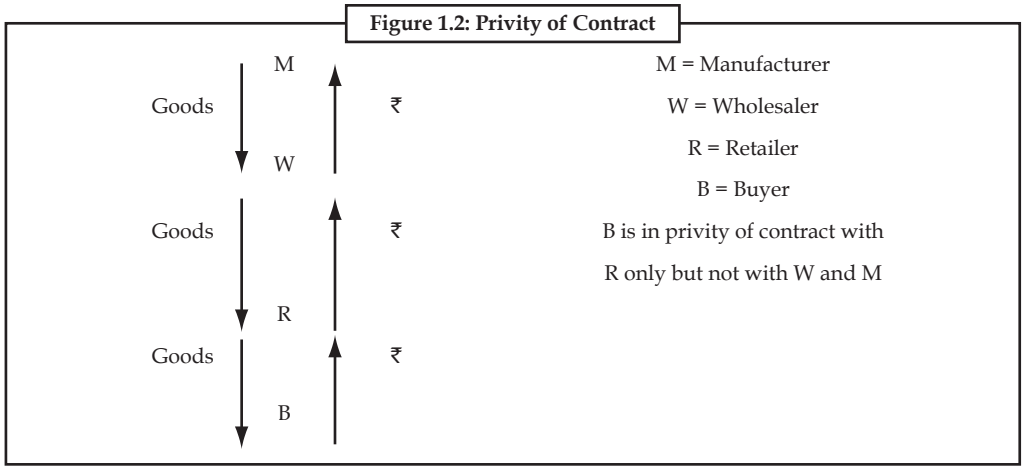
A corresponding duty is imposed on the Airlines. As there is a breach of promise by the promisor (the Airlines), the other party to the contract (i.e., *X*) has a legal remedy.

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.

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 1.2: 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.

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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 on the basis of creation:

1. ***Express contract:*** Express contract is one which is made by words spoken or written.

   

   Example: X says to Y, will you may buy a car for ₹ 100000? Y says to X, I am ready to buy you car for ₹ 100000. It is an express contract made rally.

   

   Example: X writes a letter to Y, I offer to sell my car for ₹ 100000 to you. Y send a letter to Y, I am ready to buy you car for ₹ 100000. It is an express contract made in writing.

2. ***Implied contract:*** An implied contract is one which is made otherwise than by works spoken or written. It is inferred from the conduct of a person or the circumstance of the particular case.

   

   Example: X, a coolie in uniform picks up the bag of Y to carry it from railway platform to the without being used by Y to do so and Y allow it. In this case there is an implied offer by the coolie and an implied acceptance by the passenger. Now, there is an implied contract between the coolie and the passenger is bound to pay for the services of the coolie.

3. ***Quasi or constructive contract:*** It is a contract in which there is no intention either side to make a contract, but the law imposes contract. In such a contract eights and obligations arise not by any agreement between the practice but by operation of law. E.g. where certain books are delivered to a wrong address the addresses is under an obligation to either pay for them or return them.

Contracts on the basis of execution:

1. ***Executed contract:*** It is a contract where both the parties to the contract have fulfilled their respective obligations under the contract.

   

   Example: X offer to sell his car to Y for ₹ 1 lakh, Y accepts X offer. X delivers the car to y and Y pays ₹ 1 lakh to X. It is an executed contract.

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2. ***Executory contract:*** It is a contract where both the parties to the contract have still to perform their respective obligations.

Example: X offers to sell his car to Y for ₹ 1 lakh. Y accepts X offer. It the car has not yet been delivered by X and the price has not yet been paid by Y, it is an Executory contract.

Bilateral and Unilateral: It is a contract where one of the parties to the contract has fulfilled his obligation and the other party has still to perform his obligation. E.g. X offers to sell his car to y for ₹ 1 lakh on a credit of 1 month. Y accepts X offer. X sells the car to Y. Here the contract is executed as to X and Executory as to Y.

Contracts on the basis of enforceability:

1. ***Valid contract:*** A contract which satisfies all the conditions prescribed by law is a valid contract. E.g. X offers to marry Y. Y accepts X offer. This is a valid contract.

2. ***Void Contract:*** The term void contract is described as under Section 2(j) of ICA, 1872, A contract which cases to be enforceable by law becomes void when it ceases to be enforceable. In other words, a void contract is a contract which is valid when entered into but which subsequently became void due to impossibility of performance, change of law or some other reason. For example, X offers to marry Y. Y accepts X offer. Later on Y dies this contract was valid at the time of its formation but became void at the death of Y.

3. ***Void Agreement:*** According to Section 2(g), an agreement not enforceable by law is said to be void. Such agreements are void-ab-initio which means that they are unenforceable right from the time they are made. For example, in agreement with a minor or a person of unsound mind is void-ab-initio because a minor or a person of unsound mind is incompetent to contract.

4. ***Voidable contract:*** According to Section 2(i) of the Indian Contract Act, 1872, arrangement which is enforceable by law at the option of one or more of the parties thereon but not at the option of the other or other, is a voidable contract.

   In other words, A voidable contract is one which can be set aside or avoided at the option of the aggrieved party. Until the contract is set aside by the aggrieved party, it remains a valid contract.

   For example, a contract is treated as voidable at the option of the party whose consent has been obtained under influence or fraud or misinterpretation.

Example: X threatens to kill Y, if the does not sell his house for ₹ 1 lakh to X. Y sells his house to X and receives payment. Here, Y consent has been obtained by coercion and hence this contract is void able at the option of Y lakh which he had received from X. If Y does not exercise his option to repudiate the contract within a reasonable time and in the meantime Z purchases that house from X for 1 lakh in good faith. Y can not repudiate the contract.

5. ***Illegal Agreement:*** An illegal agreement is one the object of which is unlawful. Such an agreement cannot be enforced bylaw. Thus, illegal agreements are always void-ab-initio (i.e. void from the very beginning), e.g. X agrees to Y ₹ 1 lakh Y kills Z. Y kill and claims ₹ 1 lakh. Y cannot recover from X because the agreement between X and Y is illegal and also its object is unlawful.

6. ***Unenforceable contract:*** It is contract which is actually valid but cannot be enforced because of some technical defect (such as not in writing, under stamped). Such contracts can be enforced if the technical defect involved is removed.

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1.4 Essential Elements of Valid Contract

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" As per the above section, a contract must have the following elements.

1. ***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.

2. ***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.

   Example: A husband promised to pay his wife a household allowance of £ 30 every month. Later the parties separated and the husband failed to pay the amount. The wife sued for the allowance. Held, agreements such as these were outside the realm of contract altogether [*Balfour vs. Balfour*, (1919) 2 K.B. 571]

   In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is rebuttable which means that it must be shown that the parties did not intend to be legally bound.

   Example: (a) There was an agreement between R Company and C Company by means of which the former was appointed as the agent of the latter. One clause in the agreement was: "This agreement is not entered into .... as a formal or legal agreement, and shall not be subject to legal jurisdiction in the law courts." Held, there was no binding contract as there was no intention to create legal relationship [*Rose & Frank Co. vs. Corruption Bros.* (1925) A.C. 445].

   (b) In an agreement, a document contained a condition "that it shall not be attended by or give rise to any legal relationship, rights, duties, consequences whatsoever or be legally enforceable or be the subject of litigation, but all such arrangements, agreements and transactions are binding in honour only." Held, the condition was valid and the agreement was not binding [*Jones vs. Vemon's Pools. Ltd.* (1938)].

3. ***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.

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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.

4. ***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.

5. ***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 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.

6. ***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.

7. ***Agreement not expressly declared void:*** Section 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.

8. ***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

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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.

9. ***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 100 feet, 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.

10. ***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.

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 12th Commissioner 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 Commissioner. This was an express condition precedent and by Robinson signing, he has an implied good faith effort to allow the Commissioner the opportunity to accept. Robinson's power of revocation was temporarily suspended while he was waiting to be approved by the Commissioner. His later revocation is considered a antipatory repudiation. Subsequently, when the Commissioner 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

1.5 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.

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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.

Example: (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.

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 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.

Example: (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.

1.6 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.

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Example: (i) A promises to render services for the conduct of litigation in consideration of payment of 50 per cent 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 *bonafide*, it would not be enforced, the reward being extortionate and unconscionable.

1.6.1 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 vs. Dayaldas*, (1942) Sind, 114].

Example: (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 vs. 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. vs. 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 vs. Raj Coomar* (1874) 14 Beng L.R. 76].

1.6.2 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.

Example: (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.

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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 vs. 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.

1.6.3 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.

(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.

1.6.4 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.

Notes

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

The performance of a contingent contract depends upon happening or non-happening of some future event. 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 collaterial event. (ii) A promises to pay B ₹ 10,000 if he marries C, it is not a contingent contract. 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.

Table 1.1: Difference between 'Contingent Contract' and 'Wagering Agreement'

Wagering Agreement	Contingent Contract
Reciprocal and Mutual Promises	Not necessarily
Contingent in nature	Not wagering in nature
Void	Valid
Game of chance/interest	Not a game of chance
No intention to perform	Intention to perform

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'.
- 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.

Notes

- 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: 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.

Notes

State whether the following statements are true or false:

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.
9. Over a cup of coffee in a restaurant, A invites B to a dinner at his house on a Sunday. B hires a taxi and reaches A's house at the appointed time, but A fails to perform his promise. Can B recover any damages from A ?

   [Hint: No, *Balfour* vs. *Balfour).*
10. State whether there is any contract in the following cases:

    (a) A engages B for 11 certain work and promises to pay such remuneration as shall be fixed by C. B does the work.

    (b) A and B promise to marry each other.

    (c) A takes a seat in a public vehicle.

    (d) A invites B to a card party. B accepts the invitation.

    [Hint: (a) There is a contract between A and B and A is bound to pay the remuneration as shall be fixed by C. If C does not fix, or refuses to fix the remuneration, A is bound to pay a reasonable remuneration. (b) and (c) There is a contract between A and B. (d) There is no contract.]
11. A forced B to enter into a contract at the point of pistol. What remedy is available to B. if he does not want to be bound by the contract ?

    [*Hint:* He can repudiate the contract as his consent is not free.]

Notes

12. M mows L's lawn without being asked by L to do so. L watches M do the work but does not attempt to stop him. Is L bound to pay any charges to M?

    [*Hint:* Yes, L is bound to pay M a reasonable remuneration.]

13. C orally offered to pay A, an auto mechanic, ₹ 50 for testing a used car which C was about to purchase from D. A agreed and tested the car. C paid A ₹ 50 in cash for his services. Is the agreement between C and A (a) express or implied, (b) executed or executory, (c) valid, void, voidable or unenforceable?

    [*Hint:* The agreement is (a) express, (b) executed, and (e) valid.]

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.

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

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

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)

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.

Notes

Example: (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 offerer.

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

Examples: 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.

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.

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.

Example: 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 in-charge 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.

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.

Example: 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.

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

Notes

may be accepted by any one by complying with the terms of the offer. The celebrated case of *Carlill vs. 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 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.

2.3 Difference 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.
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.

Notes

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.***

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 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 vs. Moothia Chetti*, 2 Bom L R 556]. Held, there was no contract.

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".

Notes

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).

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 vs. 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.

Legal Rules as to Acceptance

The acceptance of an offer is the very essence of a contract. To be legally effective, it must satisfy the following conditions:

1. ***It must be absolute and unqualified***, i.e., it must conform with the offer. An acceptance, in order to be binding, must be absolute and unqualified [Sec. 7 (1)] in respect of all terms of the offer, whether material or immaterial, major or minor. If the parties are not ad idem on all matters concerning the offer and acceptance, there is no contract.

Notes

Examples: (a) A made an offer to B to purchase a house with possession from 25th July.

The offer was followed by an acceptance suggesting possession from 1st August. Held, there was no concluded contract [*Routledge v. Grant*, (1828) 4 Bing. 6531].

(b) M offered to sell a piece of land to N at £ 280. N accepted and enclosed £ 80 with a promise to pay the balance by monthly instalments of £ 50 each. Held, there was no contract between M and N, as the acceptance was not unqualified [*Neale v. Merret*, (1930) W.N. 189].

(c) N offered to buy J's horse if warranted quiet in harness. J agreed to the price and warranted the horse quiet in double harness. Held, there was no acceptance [*Jordon v. Norton*, (1838) 4 M. & W. 155].

(d) A says to B, "I offer to sell my car for ₹ 50.000." B replies, "I will purchase it for ₹ 45,000." This is no acceptance and amounts to a counter-offer.

2. ***It must be communicated to the offeror.*** To conclude a contract between the parties; the acceptance must be communicated in some perceptible form. A mere resolve or mental determination on the part of the offeree to accept an offer, when there is no external manifestation of the intention to do so, is not sufficient [*Bhagwan Dass Kedia v. Girdhari Lal*, A.I.R. (1966) S.C. 543]. In order to result in a contract, the acceptance must be a "matter of fact".

Examples: (a) A tells B that he intends to marry C, but tells C nothing of his intention.

There is no contract, even if C is willing to marry A.

(b) F offered to buy his nephew's horse for £ 30 saying: "If I hear no more about it I shall consider the horse is mine at £ 30." The nephew did not write to F at all, but he told his auctioneer who was selling his horses not to sell that particular horse because it had been sold to his uncle. The auctioneer inadvertently sold the horse. Held, F had no right of action against the auctioneer as the horse had not been sold to F, his offer of £ 30 not having been accepted [*Felthouse v. Bindley*, (1862) 11 C.B. (N.S.) 869].

(c) A draft agreement relating to the supply of coal was sent to the manager of a railway company for his acceptance. The manager wrote the word 'approved' and put the draft in the drawer of his table intending to send it to the company's solicitor for a formal contract to be drawn up. By some oversight the document remained in the drawer. Held, there was no contract [*Brogden v. Metropolitan Rail Co.*, (1877) 2 A.C. 666].

In some cases the offeror may dispense with the communication of acceptance. It happens when the performance of certain conditions takes place, or some required act is done (Sec. 8). For example, in *Carlill v. Carbolic Smoke Balls Co.*, (1893) I Q.B. 256, where Carlill used the smoke balls of the company according to its directions and contracted influenza, it amounted to acceptance of the offer by doing the required act and she could claim the reward.

3. ***It must be according to the mode prescribed or usual and reasonable mode.*** If the acceptance is not according to the mode prescribed, or some usual and reasonable mode (where no mode is prescribed) the offeror may intimate to the offer within a reasonable time that the acceptance is not according to the mode prescribed and may insist that the offer must be accepted in the prescribed mode only. If he does not inform the offeree, he is deemed to have accepted the acceptance [Sec. 7 (2)].

Notes

Example: A makes an offer to B and says: "If you accept the offer, reply by wire." B sends the reply by post. It will be a valid acceptance unless A informs B that the acceptance is not according to the mode prescribed.

4. ***It must be given within a reasonable time.*** If any time limit is specified, the acceptance must be given within that time. If no time limit is specified, it must be given within a reasonable time.

Example: On June 8 M offered to take shares in R company. He received a letter of acceptance on November 23. He refused to take the shares. Held, M was entitled to refuse as his offer had lapsed as the reasonable period during which it could be accepted had elapsed [*Ramsgate Victoria Hotel Co. v. Montefiore*, (1886) L.R. 1 Ex. 109].

5. ***It cannot precede an offer.*** If the acceptance precedes an offer, it is not a valid acceptance and does not result in a contract.

Example: In a company, shares were allotted to a person who had not applied for them. Subsequently when he applied for shares, he was unaware of the previous allotment. The allotment of shares previous to the application is invalid.

6. ***It must show an intention on the part of the acceptor to fulfil terms of the promise.*** If no such intention is present, the acceptance is not valid.

7. ***It must be given by the party or parties to whom the offer is made.***

8. ***It must be given before the offer lapses or before the offer is withdrawn.***

9. ***It cannot be implied from silence.*** The acceptance of an offer cannot be implied from the silence of the offeree or his failure to answer, unless the offeree has by his previous conduct indicated that his silence means that he accepts.

Examples (a) A wrote to B, "I offer you my car for ₹ 50,000. If I don't hear from you in seven days, I shall assume that you accept." B did not reply at all. There is no contract.

(b) *Harvey v. Facey*, (1893) App. Cas. 552 discussed earlier in this Unit.

Acceptance given by a person other than the offeree or by a person who is not authorised to give acceptance is ineffective in law. Likewise information received from an unauthorised person is ineffective [*Powel v. Lee*, (1908) 24 T.L.R. 606].

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.

Notes

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.

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].

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.

Notes

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 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 Summary

- 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.

Notes

- 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 lump sum is completely performed, but badly, the person who has performed can claim the lump sum less deduction for bad work.

2.9 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.

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.

2.10 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 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.

Notes

6. 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.

7. Obligation of a person enjoying benefits of ..... act.

2.11 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".

7. Discuss the rules regarding communication of offer and acceptance.

8. "A stranger to a contract cannot maintain a suit". Discuss.

9. A tells B in the course of a conversation with him that he will give ₹ 10,000 to anyone who marries his daughter with his consent. B marries A's daughter with A's consent. Is he entitled to recover this amount ?

   [*Hint:* No, as what A tells B is a statement of intention (Re Ficus)].

9. A sees a rate book displayed in a shop. It is labelled "First Edition ₹ 15." A enters the shop and puts ₹ 15 on the counter and asks for the book. The bookseller does not agree to sell saying that the real price of the book is ₹ 50 and that it had been marked as ₹ 15 by mistake. Is the bookseller bound to sell the book for 15?

   [*Hint:* No (Pharmaceutical Society of Great Britain v. Boots Cash Chemists).]

10. A sent a telegram to B, "Will you sell your car 7. Quote lowest price." B sent a reply "Lowest price ₹ 25,000". A sent a second telegram to B, "1 agree to buy your car for ₹ 25,000." B thereafter refuses to sell. (a) Can A compel B to do so 7 (b) Is there a contract between A and B ?

    [*Hint:* (a) No. (b) No (Harvey v. Facey).]

11. B offered to sell his house to A for ₹ 50,000. A accepted the offer by post. On the next day, A sent a telegram withdrawing the acceptance which reached B before the letter. (a) Is the revocation of acceptance valid? (b) Would it make any difference if both the letters, communicating acceptance and the telegram communicating revocation of acceptance, reach B at the same time ?

    [*Hint:* (a) Yes. (b) If A opens the telegram first (and this would be normally so in case of a rational-person) and reads it, the acceptance stands revoked. If he opens the letter first and reads it, revocation of acceptance is not possible as the contract has already been concluded (Sec. 4)].

Notes

12. On the 5th of a month A makes an offer to B, by a letter which reaches B on the 6th. On the 7th B posts his letter of acceptance. Meanwhile, on the 6th A posts a letter to B revoking the offer. On seeing it B sends a telegram to A on the 8th confirming the acceptance given through his letter of the 7th. Discuss the legal effects of the three letters and the telegram.

    [*Hint:* The contract is concluded between A and B on 7th when B posts the letter of acceptance. It is assumed that the letter of A revoking offer reaches B after B has posted the letter of acceptance. The telegram only confirms acceptance already given (Secs. 4 and 5).]

13. A offers, by a letter, to sell a certain article to B who receives the letter the next day. B immediately posts his letter of acceptance. The same evening A posts a letter revoking the offer. A's letter of revocation and B's letter of acceptance crossing the post. Is there a contract between A and B?

    [*Hint:* Yes (Secs. 4 and 5)]

Answers: Self Assessment

1.	implied	2.	prospective shareholder	3.	Acceptance
4.	decline	5.	claim	6.	payment of money
7.	non-gratuitous				

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

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

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 and acceptance. 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.

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.

Notes

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 of 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.

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.

Notes

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 he 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 of 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 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).

Example: (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.

Notes

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 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

Notes

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 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.
- 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 of 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.

Notes

3.3 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.

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.

3.4 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.

3.5 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. For a loan of ₹ 15,000 to be received in three annual instalments, A (the borrower) executed a simple mortgage of his property in favour of B (the lender) – the borrower receiving ₹ 5,000 towards the first instalment, at the time of executing the mortgage deed. Examine B's rights on the mortgage deed, and respecting the money paid over to A: (i) If B did not know that A was a minor. (ii) If B knew that A was a minor. (iii) If A fraudulently misrepresented his age. (iv) If the moneys paid to A were required for advanced studies abroad.

Notes

[*Hint:* The mortagage deed is void in the first three cases and B cannot claim the money. In case (iii) if the money is traceable, the Court may ask the minor to restore it. In case (iv) the minor's property is liable under Sec. 68.]

7. A minor falsely representing himself to be of age, enters into an agreement to sell his property to R and receives from him as price a sum of ₹ 72,000 in advance. Out of this sum, the minor purchases a car for ₹ 60,000 and spends the rest on a pleasure trip. After the minor has attained majority, R sues him for the conveyance of the property or in the alterative for the refund of ₹ 72,000 and damages. How would you decide?

   [*Hint:* A minor's agreement is void (*Mohiri Bibi v. Dharmodas Ghose*). The Court may direct the minor to restore the car to R.]

8. A minor who wanted to become a professional billiards player entered into a contract with a famous billiards player and agreed to pay him a certain sum of money to learn the game. Is he liable to pay?

   [*Hint:* No. It is only his estate which is liable (*Roberts v. Gray*).]

9. A. an adult, said to M, a minor: "I will not pay the commission I promised you for selling my magazines. You are a minor and cannot force me to pay." Is A right?

   [*Hint:* No. A minor can be a beneficiary or a promisee.]

10. A is aged 17 years. He enters into an agreement with B for hiring out certain machinery belonging to B. After the agreement was signed, A backs out of the agreement and B wants to enforce the same. Discuss with reasons whether B will succeed or not.

    [*Hint:* B will not succeed.]

Answers: Self Assessment

1.	minor	2.	Section 68	3.	liable
4.	insolvent	5.	agreement		

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

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

Unit 4: Consideration

Notes

CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain the definition of consideration
- Discuss rules regarding consideration

Introduction

In last unit you have studied about the capacity of contract. Consideration is one of the essential elements to support a contract. Subject to certain exceptions, an agreement made without consideration is *nudum pactum* (a nude contract) and is void. Consideration is a technical term used in the sense of quid pro quo (i.e., something in return). When a party to an agreement promises to do something, he must get "something" in return. This "something" is defined as consideration. In the words of Pollock, "consideration is the price for which the promise of the other is bought, and the promise thus given for value is enforceable." (Pollock on Contracts, 13th ed., p. 113]. A agrees to sell his car to B for ₹ 50,000. Car is the consideration for B and price, the consideration for A.

4.1 Definition of Consideration

In the English case of Currie v. Misa, (1875) L.R. 10 Ex. 153, consideration was defined by Lush J. as follows:

"A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other. "But to this definition there should be added that "the benefit accruing or the detriment sustained was in return for a promise given or received."

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The definition in *Currie v. Misa.* in effect, means that consideration must result in a *benefit* to the promisor, and a detriment or loss to the promisee, or a *detriment* to both, e.g., A lends his bicycle to B who promises to return it after use. This results in a benefit to B (as he gets the use of the bicycle) and a detriment to A (as he parts with his bicycle) which is in consideration to support the promise to return the bicycle.

Justice Patterson defines consideration in the following words. "Consideration means something which is of some value in the eye of law ... It may be some benefit to the plaintiff or some detriment to the defendant" [*Thomas* v. *Thomas,* (1842) 2 Q.B. 851]. There are two leading cases which explain this point

Abdul Aziz, v. *Masum Ali* (1914) 36 All. 268. The secretarym, a Mosque Committee, filed a suit to enforce a promise which the promisor had made to subscribe ₹ 500 to the rebuilding of a mosque, held, "the promise was not enforceable because there was no consideration in the sense of benefit", as "the person who made the promise gained nothing in return for the promise made", and the secretary of the Committee to whom the promise was made, suffered no detriment as nothing had been done to carry out the repairs. Hence, the suit was dismissed.

Kedar Nath v. *Gauri Mohamed,* (1886) 14 Cal. 64. The facts of this case were almost similar to those of the previous case, but the secretary in this case incurred a liability on the strength of the promise. Held, the amount could be recovered, as the promise resulted in a sufficient detriment to the secretary. The promise could, however, be enforced only to the extent of the liability (detriment) incurred by the secretary. In this case, the promise, even though it was gratuitous, became enforceable because on the faith of the promise the secretary had incurred a detriment.

Sec. 2 (d) defines consideration as follows: "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."

Consideration, if we analyse this definition, may be:

(1) An act, i.e., doing of something. In this sense consideration is in an affirmative form.

Example. A promises B to guarantee payment of price of the goods which B sells on credit to C. Here selling of goods by B to C is consideration for A's promise.

The act must not however be one which one is under a legal duty to perform. This point has been Explained later in this Unit.

(2) An *abstinence* or *forbearance,* i.e., abstaining or refraining from doing something. In this sense consideration is in a negative form.

Examples. (a) A promises B not to file a suit against him if he pays him ₹ 500. The abstinence of A is the consideration for B's payment.

(b) L filed a suit against *T,* his tenant, for possession of premises and arrears of rent. The suit was decreed in his favour. In execution, L obtained an order for attachment of movable property of *T.* In consideration of *T* agreeing not to appeal against the decree L allowed him one month's time to pay the balance of decretal amount and vacate the premises. *Held,* the agreement was valid [*Gousmohoddin* v. *Appasahib* A.I.R. (1976) Knt. 90].

The act or abstinence which forms the consideration may be a past, present or future one. (3) A *return promise.*

Example. A agrees to sell his horse to B for ₹ 10,000. Here B's promise to pay the sum of ₹ 10,000 is the consideration for A's promise to sell the horse, and A's promise to sell the horse is the consideration for *B's* promise to pay the sum of ₹ 10,000.

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

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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 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.

4.2 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.

4.3 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

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month. With a view to reduce the municipal tax, A 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.

4.4 Stranger to Contract

It is a general rule of law that only parties to a contract may sue and be sued on that contract.

This rule is known as the doctrine of privity of contract. "Privity of contract" means relationship subsisting between the parties who have entered into contractual obligations. It implies a mutuality of will and creates a legal bond or tie between the parties to a contract.

There are two consequences of the doctrine of privity of contract:

(1) A person who is not a party to a contract cannot sue upon it even though the contract is for his benefit and he provided consideration.

(2) A contract cannot confer rights or impose obligations arising under it on any person other than the parties to it. Thus, if there is a contract between A and B, C cannot enforce it.

Example: 5 bought tyres from the Dunlop Rubber Co. and sold them to D, a sub-dealer, who agreed with S not to sell these tyres below Dunlop's list price and to pay the Dunlop Co. £5 as damages on every tyre D undersold. D sold two tyres at less than the list price and thereupon the Dunlop Co. sued him for the breach. Held, the Dunlop Co. could not maintain the suit as it was a stranger to the contract [*Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge & Co. Ltd.*, (1915) AC. 847].

Exceptions. The following are the exceptions to the rule that "a stranger to a contract cannot sue":

(1) ***A trust or charge.*** A person (called beneficiary) in whose favour a trust or other interest in some specific immovable property has been created can enforce it even though he is not a party to the contract [*Madhu Trading Co. v. Union of India & Others*, AIR (1979) NOC 47 (Delhi)].

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Example: (a) A agrees to transfer certain properties to be held by T in trust for the benefit of B. B can enforce the agreement (i.e., the trust) even though he is not a party to the agreement [*M. K. Rapai v. John*, AIR (1965) Ker. 203].

(b) A husband who was separated from his wife executed a separation deed by which he promised to pay to the trustees all expenses for the maintenance of his wife. Held, the agreement created a trust in favour of the wife and could be enforced [Gandy v. Gandy (1884) 30 Ch. D. 57].

(c) A had a son SA and B had a daughter DB. A agreed with B that in consideration of the marriage of DB with SA, he (A) would pay to DB, his daughter-in-law, an allowance of ₹ 500 a month in perpetuity. He created a charge on certain properties for the payment and conferred power on DB to enforce it. Held, DB, although no party to the agreement, was clearly entitled to receiver the arrears of the allowance [*Khwaja Mohd. Khan v. Hussani Begum*, (1910) 32 All. 410].

(2) ***Marriage settlement, Partition or other family arrangements.*** When an arrangement is made in connection with marriage, partition or other family arrangements and a provision is made for the benefit of a person, he may sue although he is not a party to the agreement.

Example: (a) Two brothers, on a partition of joint properties, agreed to invest in equal shares a certain sum of money for the maintenance of their mother. Held, she was entitled to require her sons to make the investment [*Shuppu Ammal v. Subramaniyam*, (1910) 33 Mad. 2].

(b) J's wife deserted him because of his ill treatment. J entered into an agreement with his father-in-law to treat her properly or else pay her monthly maintenance. Subsequently she was again ill-treated and also driven out. Held, she was entitled to enforce the promise made by J to her father [*Daropti v. Jaspat Rai*, (1905) PR 17].

(c) A mother agreed to pay to her younger son in the event of the failure by the elder son to pay to the younger son the amount which fell short of the younger son's share in the assets left by their father. The agreement was made to purchase peace for the family. Held, it was a valid family arrangement creating liability of mother [*Commissioner of Wealth Tax v. Vijayaba*, AIR (1979) S.C. 982].

(3) ***Acknowledgement or estoppel.*** Where the promisor by his conduct, acknowledges or otherwise constitutes himself as an agent of a third party, a binding obligation is thereby incurred by him towards the third party.

Example: A receives some money from T to be paid over to P. A admits of this receipt to P. P can recover the amount from A who shall be regarded as the agent of P.

(4) ***Assignment of a contract.*** The assignee of rights and benefits under a contract not involving personal skill can enforce the contract subject to the equities between the original parties [*Krishan Lal Sadhu v. Promila Bala*, AIR (1928) Cal. 518]. Thus the holder in due course of a negotiable instrument can realise the amount on it even though there is no contract between him and the person liable to pay.

(5) ***Contracts entered into through an agent.*** The principal can enforce the contracts entered into by his agent provided the agent acts within the scope of his authority and in the name of the principal.

(6) ***Covenants running with the land.*** In cases of transfer of immovable property, the purchaser of land with notice that the owner of the land is bound by certain conditions or covenants created by an agreement affecting the land shall be bound by them although he was not party to the original agreement which contained the conditions or covenants [*Tulk v. Moxhay* (1919) 88 LJ KB 861].

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4.5 Summary

- 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.

4.6 Keywords

Consideration: "A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other. "But to this definition there should be added that "the benefit accruing or the detriment sustained was in return for a promise given or received."

Illegal Consideration: Renders a contact void.

4.7 Self Assessment

Fill in the blanks:

1. ..... renders a contract void.
2. An agreement which ..... with morals of the time and contravenes any established interest of society is void as being against public policy.
3. ..... 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".

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4. Every person has a right to have recourse to the usual ..... .
5. 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 ..... .

4.8 Review Questions

1. "Insufficiency of consideration is immaterial but an agreement without consideration is void". Comment.
2. Consideration may be present, past or future. Illustrate.
3. Are there any exceptions to the rule "No consideration, No contract".
4. "A stranger to a contract cannot maintain a suit but a stranger to consideration can do so". Comment.
5. 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.
6. A, being in dire need of money, sells his new car purchased two months ago at a cost of ₹ 1,72,000 for ₹ 11,000. Afterwards A seeks to set aside the contract on the ground of inadequacy of consideration. Will he succeed?

   [*Hint:* No]
7. A, Band C enter into a contract, under which A promises both Band C that if B will dig A's garden, he (A) will give ₹ 50 to C. Can C compel A to pay the money on B's digging A's garden according to the terms of the contract? Give reasons.

   [*Hint:* Yes]
8. A's uncle in a sudden display of generosity promises him a watch as a gift on his next birthday. If the uncle fails *to,* give the watch' can A do anything about it ?

   [*Hint:* No]
9. A's scaffolding fell down on his neighbour, B, who was injured. B threatened to bring suit against A unless the latter paid him ₹ 500 within ten days as compensation for his injuries. *A* promised but later refused to pay, claiming that there was no consideration for his promise. Can B recover the amount?

   [*Hint:* Yes]
10. A Muslim lady sued her father-in-law to recover arrears of allowance payable to her by him under an agreement between him and her own father in consideration of her marriage. Will she succeed?

    A's car breaks down on G.T. Road. He asks B, a passing motorist, to tow the car to nearest garage. B tows the car and in return A promises to pay B at the garage ₹ 200 as payment for his trouble. Is A bound by his promise?

    [*Hint:* Yes (Sec. 25 (2)].
11. A agrees for a sum of ₹ 5,00,000 to construct for B a building, according to plans and specifications. When A has completed half the work he threatens to quit unless B agrees to pay him an additional ₹ 50,000. B so promises, A completes the work and asks for the additional sum. Decide.

    [*Hint:* A cannot recover the additional sum of ₹ 50,000 as B's promise to pay the additional sum was without consideration].

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12. A and B, two Hindu brothers, divided the family property between them and agreed at the time of partition that they should contribute a sum of ₹ 10,000 in equal shares and invest it in the security of immovable property and pay the interacts towards the maintenance of their mother. Can the mother compel her sons to have the amount invested as settled in her favour?

    [Hint: Yes *(Dan* Kuerv. *Sarlo Deui,* (1947) Bom. L.R. 123)].

13. P is a manufacturer of light bulbs. He advertises in the trade press that in future the retail price of his bulbs will be ₹ 4 and that proceedings will be taken against any dealer not observing this price. *T* buys a quantity of the bulbs from X, a wholesaler. Although *T* had originally read the advertisement, he forgot its contents and retails the bulbs at ₹ 4.25. Advise *R.*

Answers: Self Assessment

1. Illegal consideration
2. conflicts
3. Section 27
4. legal proceedings
5. Limitation Act, 1963

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

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

Notes

Unit 5: 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.

5.1 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.

5.1.1 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

Case Study

Threat to commit suicide-Does it amount to coercion?

The question whether a threat to commit suicide amounts to coercion arose in *Chi k ham Amiraju* v. *Seshamma,* (1917) 41 Mad. 33. In this case, a person held out a threat of committing suicide to his wife and son if they did not execute a release in *favour* of his brother in respect of certain properties. The wife and son executed the release deed under the threat. *Held,* "the threat of suicide amounted to coercion within Sec. 15 and the release deed was, therefore, *voidable."* In another case. *Purabi Bannerjee v. Basudev MukerJee,* A.I.R. (1969) Cal. 293, it was observed that "one committing suicide places himself or herself beyond the reach of the law, and necessarily beyond the reach of any punishment too. But it does not follow that suicide is not forbidden by the Penal Code. Sec. 306 of the Penal Code punishes abetment of suicide. Sec. 309 punishes an attempt to commit suicide. Thus suicide as such is no crime, as indeed, it cannot be. But its attempt is; its abetment too is. So, it may very well be said that the Penal Code does forbid suicide."

As such, a threat to commit suicide amounts to coercion.

Duress. In the English Law, the near *equivalent* of the term 'coercion' is 'duress'. Duress involves actual or threatened *violence over* the person of another (or his wife, parent, or child) with a *view* to obtaining his consent to the agreement. If the threat is with regard to the goods or property of the other party, it is not duress.

5.1.2 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.

Notes

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.

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 per cent the transaction may be held to be unconscionable and a reduced rate of simple interest may be awarded.

5.1.3 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.

Notes

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.

5.1.4 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].

Notes

(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.

(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. vs. 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.

Notes

5.1.5 Meaning of 'Mistake'

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:

1. Mistake of fact
2. Mistake of law.

Mistake of Fact

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. 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.

The mistake must be mutual, i.e. both the parties should misunderstand each other and should be at cross-purposes.

The mistake must relate to a matter of fact essential to the agreement. As to what facts are essential in an agreement will depend upon the nature of the promise in each case.

Example. A man and a woman entered into a separation agreement under which the man agreed to pay a weekly allowance to the woman, mistakenly believing themselves lawfully married. *Held,* the agreement was void as there was mutual mistake on a point of fact which was material to the existence of the agreement *[Galloway* v. *Galloway,* (1914) 30 T.L.R. 531].

But an erroneous opinion as to the value of a thing which forms the subject-matter of an agreement is not to be deemed a mistake as to a matter of fact (Explanation to Sec. 20).

Example. A buys an old painting for ₹ 5,000 thinking that it is an excellent piece of art. Actually the painting is a new one and is worth only ₹ 500. A cannot avoid the contract on the ground of mistake.

The various cases which fall under bilateral mistake are as follows :

(1) Mistake as to the subject-matter. Where both the parties to an agreement are working under a mistake relating to the subject-matter, the agreement is *void.* Mistake, as to the subject-matter *covers* the following cases:

Notes

(i) *Mistake* as *to the existence of the subject-matter.* If both the parties *believe* the subject-matter of the contract to be in existence, which in fact at the time of the contract is non-existent, the contract is void.

Examples. (a) A agreed to sell a cargo of corn supposed at the time of the contract to be in transit from Salonica to the United Kingdom. Unknown to the parties, the corn had become fermented and had already been sold by the master of the ship at Tunis. *Held,* the agreement was void and the buyer was not liable for the price *[Couturier v. Hastie,* (1856) 5 H.L.e. 673].

(b) A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of the bargain, though neither party was aware of the fact. The agreement is *void.*

(ii) *Mistake* as *to the identity of the subject-matter.* It usually arises where one party intends to deal in one thing and the other intends to deal in another.

Examples. (a) W agreed to buy from *R* a cargo of cotton "to *arrive ex-peerless* from Bombay". There were two ships of that name sailing from Bombay, one sailing in October and the other in December. W meant the former ship but *R* meant the latter. *Held,* there was a mutual or a bilateral mistake and there was no contract [*Raf es v. Wichelhaus,* (1864) 2 H. and C.906].

(b) In an auction sale, the auctioneer was selling *tow.* A'bid for a lot, thinking it was *hemp.*

The bid was extravagant for tow, but reasonable for hemp. *Held,* there was no contract *[Scriven Bros.* & *Co. v. Handley* Co., (1913) 3 KB. 564].

The result is the same *even* if the mistake was caused by the negligence of a third party.

Example. A who inspected fifty rifles in *B's* shop inquired from him the price of the rifles.

Later, he wired B, "*Send three rifles".* By mistake of the telegraph clerk the message transmitted to B was "*Send the rifles".* B sent fifty rifles. A, however, accepted three rifles and sent back the rest. *Held,* there was no contract. But A had to pay for the three rifles on the basis of an implied contract [*Henkel v. Pape,* (1807) L.R. 6 Ex. 7].

(iii) Mistake as *to the quality of the subject-matter.* If the. subject-matter is something essentially different from what the parties thought it to be the agreement is *void.*

2. *Mistake as to the possibility of the performing the contract*: Consent is nulliefied if both the parties believe that an agreement is capable of being performed when in fact this is not the case(sec.56,para1) the agreement , in such case, is void on the ground of impossibility .

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.

A unilateral mistake is generally not allowed as a defence in avoiding a contract. But in certain cases, the consent is given by a party under an error or mistake which is so fundamental as goes to the root of the agreement. In such cases the agreement is void. Thus in the following cases, even though there is a unilateral mistake, the agreement is void.

Notes

Mistake as to the identity of the person contracted with. It is a fundamental rule of law that if one of the parties represents himself to be some person other than he really is, there is a mistake as to the identity of the person contracted with.

Mistake as to the nature of contract: if a person enters into a contract in the mistaken belief that he is signing a documents of a differentclass and character altogether, there is a mistake as to the nature of the contarct and the contract is viod.

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.

5.2 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

5.3 Differences between Fraud and Misrepresentation

Notes

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 the thief 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 situations where property belongs to another but the germane to the Kezia case which would be uncovered by the court is S.5 (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

Contd....

Notes

by the colleague at the time of appropriation as a person cannot steal property that is not owned by another. 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 S.3(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 S.3 (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 S.2 (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 vs. 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."

5.4 Summary

Notes

- 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.

Notes

5.5 Keywords

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

Mistake of foreign law: The above maxim – "ignorance of law is no excuse" is in-applicable 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.

5.6 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.

5.7 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'.

Notes

9. Ram sold some land to Rohit. At the time of sale both parties believed in good faith that the area of the land sold was 10 hectares. It, however, turned out that the area was 7 hectares only. How is the contract of sale affected? Give reasons.

   [*Hint:* The agreement is void (Sec. 20).]

10. Pooja agreed to sell Richa a specific cargo of corn per 5.5. Malwa supposed to be on its way from London to Mumbai turned out that before the day of the bargain the ship had been cast away, and the goods lost. Discuss the rights of Pooja.

    [*Hint:* The agreement is void (Couturier v. *Hastie).*]

Answers: Self Assessment

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

5.8 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 6: Discharge of Contract

CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain meaning of discharge of 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.

6.1 Meaning of Discharge of Contract

A contract is discharged when rights and obligations created by it comes to an end, i.e., contracting parties no more have any responsibility or liability to each other. Discharge of contract is the termination of a contractual obligation on court orders (via an order of discharge) or mutual agreement (see Accord and Satisfaction), or caused by breach of contract, frustration of contract, performance of contract.

6.2 Modes of Discharge of Contract

Notes

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

6.2.1 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.

6.2.2 Discharge by 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.

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.

Notes

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.

6.2.3 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.

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.

   Example: (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.

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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.

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).

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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.

6.2.4 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.
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.

6.2.5 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.

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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 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.

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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.

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.

6.3 Summary

- 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.

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- 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.

6.4 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.

6.5 Self Assessment

Fill in the blanks:

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

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6.6 Review Questions

1. A sold some land to B. At the time of sale both parties believed in good faith that the area of the land sold wa hectares. It, however, turned out that the area was 7 hectares only. How is the contract of sale affected? Give reasons.

   [*Hint:* The agreement is void (Sec. 20)].

2. A agreed to sell *B* a specific cargo of corn per 5.5. Malwa supposed to be on its way from London to Mumbai turned out that before the day of the bargain the ship had been cast away, and the goods lost. Discuss the rights of A.

   [*Hint:* The agreement is void (Couturier v. *Hastie).*]

3. L, the owner of a gold mine in West Africa, sold the Mine to M. During the preliminary discussion L had certain statements about the Mine which were incorrect, though L honestly believed them to be true. After having the mine for six months M discovered the true position. What remedies, if any, will M have?

   [Hint: M can only claim damages. The contract cannot be rescinded because the parties cannot be restored to the original position *[Lagunas Nitrate Co.* v. *Lagunas Syndicate,* (1899) 2 Ch. 392.]

4. C offers to sell to D a painting which C knows is a good copy of a well-known masterpiece. D thinking that painting is an original one and that C must be unaware of this, immediately accepts D's offer. Does this result in a contract?

   [*Hint: Yes.* The doctrine of *Coueot Emptor* (Get the buyer beware) will apply.]

5. A and B, being traders, enter into a contract. A has private information of a change in prices which would affect willingness to proceed with the contract. Is A bound to inform B ?

6. What are the different modes of discharge of contracts? Explain the discharge of contract by performance or tender.

7. (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.

8. Discuss the consequences of non-performance of a valid contract.

9. 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				

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

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

Notes

Unit 7: Remedies for Breach of Contract

CONTENTS

Objectives

After studying this unit, you will be able to:

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

Introduction

In last unit you have studied about different modes discharge of contract. 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.

7.1 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

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an agency for alternative dispute resolution; (iv) the other party may sue for damages; or (v) the other party may sue for other remedies.

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.

7.1.1 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.

7.1.2 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 (1) ***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

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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 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

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which he expected to obtain by making caps, nor the expenses which he has incurred in making preparation for the manufacture of caps.

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 Kolkata. 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 per cent 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.

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

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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.

7.1.3 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.

7.1.4 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.

7.1.5 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.

7.2 Rectification or Cancellation

When through fraud or a mutual mistake of the parties, a contract or other instrument does not express their real intention, either party may institute a suit to have the instrument rectified. In such a case, if the Court finds that there has been a fraud or mistake, it may ascertain the real intention of the parties, and may, in its discretion, rectify the instrument so as to express that intention (Sec. 26 of the Specific Relief Act, 1963). But this must not prejudice the rights acquired by third persons in good faith and for value. If rectification is not possible, the Court orders for the cancellation of the contract.

A written document which is void or voidable against a person may cause him in some cases or serious injury, if it is left outstanding. In such a case, if he has any such apprehension, he may file a suit to have the document adjudged void or voidable and order it to be delivered up and cancelled (Sec. 31 of the Specific Relief Act, 1963).

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Example: A, the owner of a ship, fraudulently representing the ship to be seaworthy induce B, an underwriter, to insure the ship, B may obtain the cancellation of the policy.

7.3 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.

7.4 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.

7.5 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.
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.

Notes

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.

7.6 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.
11. In a bond there is stipulation for payment of compound interest on failure to pay simple interest at (a) the same rate as simple interest. (b) a higher rate as was payable on the principal. Discuss whether this stipulation is a penalty.

    [*Hint:* Payment of compound interest on default (a) at the same rate as simple interest is not a penalty within the meaning of Sec. 74 (*Ganga Dayal v. Bachu Mal*, (1906) 25 All. (25). (b) at rate higher than simple interest is a penalty within the meaning of Sec. 74 [*Sunder Koer v. Rat Sham Krishan*, (1905) 34 Cal. 150.]
12. S agreed to act as sales manager for Company X for a period of three years at monthly salary of ₹ 1000. S worked for six months and then left and joined another company at a higher salary. What are the rights of Company X?

    [*Hint:* Company X may not only treat the contract as rescinded but also bring suit against S to recover any monetary loss suffered by it as a result of the breach].
13. M, a retailer of milk, supplied C with milk which was consumed by C and his family. The milk contained typhoid germs and C's daughter was infected thereby and died. Discuss the legal position of the parties.

    [*Hint:* C can recover damages from M (*Frost v. Aylesbury Diary Co. Ltd.*, (1925) 1 K.G. 608. Also refer to Problem 6 of this Unit.]

Answers: Self Assessment

Notes

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

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

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

Notes

Unit 8: Contract of Guarantee

CONTENTS

Objectives

After studying this unit, you will be able to:

- Understand the meaning and purpose of the contract of guarantee
- Explain the essential features of guarantee
- Discuss the different kinds of guarantee

Notes

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 contract 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.

8.1 Meaning and Purpose of the Contract of Guarantee

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

8.1.1 Meaning of Guarantee

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).

Notes

8.1.2 Purpose of Guarantee (S. 126)

The contract 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 contract 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.

8.2 Kinds of Guarantee

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

8.2.1 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.

8.2.2 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.

Notes

Case: (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).

8.2.3 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.

8.3 Rights and Obligations of Creditors

8.3.1 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.

8.3.2 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".

Notes

Case: 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.

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.

8.4 Rights, Liabilities and Discharge of Surety

Notes

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.

8.4.1 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.

8.4.2 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, ₹ 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.]

8.4.3 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,

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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.

8.4.4 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 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.

8.4.5 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.

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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.

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

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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.

8.5 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.
- The liability of the surety cannot be postponed till all other remedies against the principal debtor have been exhausted.

8.6 Keywords

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

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.

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

8.7 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.

8.8 Review Questions

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.

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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. S guaranteed C against the misconduct of P in an office to which P is appointed by C and of which the duties defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards misconducts himself in respect of a duty not affected by the latter Act. Is S liable as a surety?
7. Roshan contracted to buy from Rahul 100 bales of cotton at ₹ 5,000 per bale for the March, 1991 delivery. The perlormance of this contract by Rahul was guaranteed by santosh. Soon after Roshan contracted to sell to Rahul 10 bales of cotton of the same kind at ₹ 6,000 per bale, for the same delivery. Is Santosh discharged from his guarantee?
8. Ram stands as a surety for the good conduct of Ravi who is employed by a bank on a monthly salary of ₹ 1,600. Three months after when the financial position of the bank deteriorates, Ravi agrees to accept a monthly salary of ₹ 1,500, Two months after, it is discovered that Ravi has been misappropriating cash all through . What is the liability of Ram?

Answers: Self Assessment

1.	False	2.	True	3.	False	4.	True
5.	True	6.	True				

8.9 Further Readings

Books

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

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

N.D.Kapoor, "*Elements of Mercantile Law*", Sultan Chand & Sons.

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://legalservicesindia.com/article/userarticles.php?aut_id=301

http://www.lawyersclubindia.com/articles/IS-Contract-of-Insurance-a-contract-of-indemnity--3536.asp

http://www.scribd.com/doc/19575522/Contract-indemnity

Notes

Unit 9: Contract of Indemnity

CONTENTS

Objectives

After studying this unit, you will be able to:

- Understand the meaning and purpose of the contract of indemnity
- Explain the essential features of the indemnity
- Discuss the different kinds of indemnity
- State difference between indemnity and guarantee

Introduction

In last unit, you studied about Contract of guarantee. And now you will know, 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 indemnity.

9.1 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 indemnifier and indemnified. The indemnifier promises to make good the loss of the indemnified (i.e., the promisee).

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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 torturous conduct of the protected party.

9.1.1 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 (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.

9.1.2 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.

9.1.3 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].

9.1.4 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

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three parties, the 'principal debtor', the 'creditor' and the 'surety'. Other points of difference are:

Table 9.1: Difference 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.

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

Mary Coleiro vs. the State of NSW

In Mary Coleiro vs. The State of NSW and Others case, Mary Coleiro sued The State of NSW in District Court proceedings for injuries she alleged to have sustained as a result of an incident which occurred on 5 September 2000.

Ms Coleiro was a cleaner employed by Hydaree Pty Limited, a wholly owned subsidiary of Tempo Services Limited ("TSL"). TSL entered into a contract for the provision of cleaning services of public schools with the State Contracts Control Board (on behalf of the State of NSW Department of Education). Whilst on the school premises, the plaintiff alleged to have tripped and fallen on a raised section of concrete. She was not performing cleaning duties at the time, but was on her way to do so. The State of NSW ("The State") filed a cross-claim against TSL, alleging that it was obliged to indemnify it under the terms of a service contract.

Service providers can take some comfort from the case of Coleiro which supports the view that a temporal connection between the performance of the service and the loss sustained is insufficient to invoke an indemnity clause.

In *Tanksley v. Gulf Oil Corp.* This court held that an oil company cannot invoke an indemnification agreement with a contractor after settling an injured worker's claims because, by settling, the oil company foreclosed its opportunity to have a court determine that it was free from fault.

Contd...

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From the above case decisions it can be inferred that indemnity can be invoked on demand

1. Indemnity may be invoked where the claimant has a pre-existing condition that caused a loss of use of a member of the body and there is proof that the loss of use is sufficiently pronounced that an ordinary person could discover it.
2. In accordance with developed practice it is proposed that any indemnity is limited to exclude losses caused by the accountable body's negligence and that the indemnity can only be invoked once the accountable body has made reasonable endeavors to recover any reclaimed grant from the relevant project manager, which may include taking legal action.
3. Included procedures, terms and conditions in the contract to be followed for invoking the indemnity by the customer.
4. A letter of indemnity, on the other hand, permits a misrepresentation and, in consequence, it should not be invoked against consignees or third parties and, if used against them, it should have no effect. The misrepresentation must, of course, be directly related to the loss or damage complained of.
5. A letter of indemnity is a corollary to a fraud on a third party and cannot be invoked against a third party in good faith who, on the contrary, may use the letter as evidence of the bad order and condition of the goods.

Source: http://legalservicesindia.com/article/article/indemnity-in-a-contract-379-1.html

9.2 Summary

- 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.

9.3 Keywords

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.

Creditor: The person to whom the guarantee is given.

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

Surety: The person who gives the guarantee.

9.4 Self Assessment

Fill in the blanks:

1. Between co-sureties there is equality of ..... and benefit.
2. ..... 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.
3. ..... is a guarantee which extends to a series of transactions.
4. When a debt is guaranteed by two or more sureties, they are called ..... .

Notes

9.5 Review Questions

1. Define the contract of 'Indemnity'. Describe the rights of the indemnifier and the indemnity-holder.
2. "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.
3. Distinguish between a contract of guarantee and a contract of indemnity.
4. Discuss the case Mary Coleiro vs. the state of NSW. Explain indemnity.
5. A agrees to indemnify B, a newspaper proprietor, against claims arising out of the libels printed in the newspaper concerning a person of repute. Is this a valid agreement?
6. B appointed A as his agent to collect his rents and required him to execute a fidelity bond in which C was a party. Sometime after the execution of the bond, C died. A committed various acts of dishonesty after C's death. Is C's estate for loss caused to B?
7. A undertakes to build a house for B within a certain period, B supplying the necessary materials. C guarantee performance of the contract. B fails to supply the necessary materials. Discuss the position of C

Answers: Self Assessment

1. burden
2. Contract of indemnity
3. Continuing guarantee
4. Co-sureties

9.6 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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http://www.scribd.com/doc/19575522/Contract-indemnity

Unit 10: Contract of Bailment

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CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss the bailment and kinds of bailment
- State the duties of bailee
- Describe pledge as a special kind of bailment

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.

Notes

10.1 Definition of Bailment and its Kinds

Let us first understand the term bailment.

10.1.1 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 'bailer' 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).

   Examples: (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 bailer. 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).

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.

Notes

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 consume 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.

10.1.2 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., bailer;
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.

10.2 Duties and Rights of Bailer and Bailee

After understanding term bailment, let us start with duties and right of parties involved in bailment. These parties are bailer and bailee. Bailee is also termed as finder of goods.

10.2.1 Duties of a Bailer

1. ***To disclose know faults in the goods (S.150):*** The bailer is bound to disclose to the bailee faults in the goods bailed, of which the bailer 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 bailer is responsible for such damage whether he was or was not aware of the existence of such faults in goods bailed.

   

   Examples: (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.

2. ***Liability for breach of warranty as to title:*** The bailer is responsible to the bailee for any loss which the bailee may sustain by reason that the bailer 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 bailer, is responsible to make good this loss to C, the bailee.

Notes

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 bailer must repay to the bailee all necessary expenses incurred by him for the purpose of the bailment.

   In case of non-gratuitous bailments, the bailer 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 bailer.

10.2.2 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 bailer 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 bailer's goods with his own (Ss. 155-157):*** If the bailee without the consent of the bailer, mixes the goods of the bailer 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.

   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 bailer 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.

Notes

4. ***To return the goods bailed without demand (S.160):*** It is the duty of the bailee to return, or deliver according to the bailer'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 bailer 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 bailer, 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 bailer (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 bailer, the bailee is under duty to return it to bailer 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.]

10.2.3 Rights of a Bailee

Following are the rights of a Bailee:

1. The duties of the bailer are, in fact, if looked from the point of view of bailee, the bailee's rights. Thus, a bailee can sue bailer 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 (bailer 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., bailer). Lien may be of two types: (i) General Lien and (ii) Particular Lien.

   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".

Notes

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 bailer 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 bailer 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 bailer and the bailee, be dealt with according to their respective interest (S.181).

10.2.4 Rights of a Bailer

There is number of rights of a Bailer. These are:

1. The bailer can enforce, by suit, all duties or liabilities of the bailee.
2. In case of gratuitous bailment (i.e., bailment without reward), the bailer 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 bailer 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.]

10.3 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.

Notes

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 bailer 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 bailer must indemnify. Further, a gratuitous bailment terminates by the death of either the bailer or the bailee (S.162).

10.4 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.

10.4.1 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.

10.4.2 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.

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.].

Notes

10.5 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".
- The person delivering the goods is called the 'bailer' 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.

10.6 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.

10.7 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 bailer 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.

10.8 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. Comment:
   (i) "Bailer is liable to the bailee for loss caused by faults in the goods bailed whether the bailer was aware of the same or not."
   (ii) "Bailer must compensate the bailee for all expenses."
   (iii) "Bailee's right of lien is a particular lien and does not extend to other goods of the bailer in his possession."
   (iv) "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.
4. A lends a horse, which t1e knows to be vicious, to B. He does not disclose the fact that the horse is vicious. The horse runs away and B is thrown and injured. Explain the legal relationship between A and B and advise B as to his rights.

   [*Hint:* A is 'responsible for damage sustained by B (Sec. 150)].

Notes

5. A lends a book to B and B promises to return it one week before the University examination which both A and Bare to lake. B does not return the book in spite of A's repeated demands till the examination is over. A sues B for breach of contract and claims damages for the inconvenience caused to him. B pleads absence of consideration for his promise to return the book to A. Decide.

6. A guest, arriving late for dinner at a hotel, saw a number of ladies coats left in an ante-room which was previously used as supervised cloak-room. At that time, however, there was no attendant in the room, Nevertheless, she left her mink coat with the other coats. Whilst she was dining, the coat was stolen. Is the hotel owner liable for the loss?

Answers: Self Assessment

1. True
2. True
3. False
4. True
5. False

10.9 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.

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Online links

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Notes

Unit 11: Contract of Pledge

CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss the pledge as a special kind of bailment
- Explain the rights and duties of pledgor and pledgee

Introduction

In last unit, you studied about contract of bailment. At one time or another, we enter into a legal relationship called pledge. 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.

11.1 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*

Notes

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.

11.1.1 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.

11.1.2 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.
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.

11.2 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

Notes

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.

11.3 Rights and Duties of a Pledgor and a Pledgee

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.

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.

Notes

11.3.1 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).

11.3.2 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.
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.

11.3.3 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.

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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.

11.3.4 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.

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 bailer for the negligence of X's servant.].

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.

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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.)

11.4 Summary

- 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.

11.5 Keywords

Pledgee: The person to whom the goods are so delivered.

Pledgor: The person, who delivers the goods as security.

11.6 Self Assessment

Fill in the blanks:

1. A pledgee has a right to recover any ..... incurred for preservation of the goods pledged.
2. The ..... is bound to return the goods on payment of the debt.
3. 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.

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4. A ..... as the bailment of goods as security for payment of a debt or performance of a promise.
5. ..... is a right in one person to retain that which is in his possession, belonging to another, until some debt or claim is paid.

11.7 Review Questions

1. Discuss the characteristics of a pledge.
2. What are the respective rights and duties of a pawnor and a pawnee?
3. When is a pledge created by non-owners valid?
4. When a pledgor fails to redeem his pledge, what rights does the pledgee have in the pledge?
5. "Every pledge is a bailment, but every bailment is not a pledge". Discuss.
6. A picture dealer in Mumbai sends pictures to an agent in Delhi, some being for sale and some for exhibit. The dealer shortly afterwards revokes the agent's authority either to sell or to exhibit the pictures and directs hire them. In defiance of these instructions, the agent pledges the pictures with a pawnbroker. Is the pledge valid?
7. A, a doctor, by the exercise of undue influence, persuades his patient B to sell a valuable diamond to him at a very low price. A obtains possession of the diamond and pledges it with C. Is this a valid pledge?
8. A borrows ₹ 100 from B on 1st March, and pledges his wrist watch to secure the advance. Subsequently on 1st June A borrows another sum of ₹ 100 from B. A repays the first debt in full. Can B retain the wrist watch against his claim for the repayment of the second Joan?

Answers: Self Assessment

1. extraordinary expenditure
2. Pledgee
3. Demands
4. Pledge
5. Lien

11.8 Further Readings

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

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Unit 12: Law of Agency

Notes

CONTENTS

Objectives

After studying this unit, you will be able to:

- Define agency and agent
- Discuss the different kinds of agencies
- Explain the 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 Contract of pledge. 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.

Notes

12.1 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.

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.

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.

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.

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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*.

12.2 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.

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.

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.

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.

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.

Notes

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*.

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 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.

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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.
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.

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.

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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*.

12.3 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.

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.

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.

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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.

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,
   (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.

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;

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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.

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.

12.4 Duties and Rights of Agent

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.

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(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.

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.

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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 Rs 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).

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.

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

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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.

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.

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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.

12.5 Principal's Duties to the Agent and his Liabilities to Third Parties

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).

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.

   

   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 Rs 4,000 on the ship. B procures a policy of Rs 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 Rs 5,000 but he draws a bill for ₹ 10,000, the principal will not be liable even to the extent of Rs 5,000.

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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.

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.

Concealed Principal

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 Rs 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.

Notes

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.

12.6 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 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 of 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.

Notes

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.

12.7 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.

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).

   

   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.

Notes

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).

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 Rs 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.

(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.

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

12.8 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".

12.9 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.

12.10 Self Assessment

Notes

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 …….

12.11 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?
10. D, a carrier, discovers that a consignment of tomatoes owned by E has deteriorated badly before the destil reached. He, therefore, sells the consignment for what he can get; this is about a third of the market price for good E sues D for damages. 0 claims he was an agent of necessity. Advise him
11. P, a solicitor, entrusted all his work to his clerk and rarely attended to it himself. The clerk induced a c1ier conveyance of his property under the impression that it was merely apower of attorney. Later he sold the pre absconded with the money. The client sues P. Is Pliable?

Notes

12. Sandars, who was a corn factor, was entrusted by Smart with a certain quantity of wheat to sell on 11 Sandars subsequently advanced the sum of £ 3,000 to Smart, which Smart failed to repay, Smart gave orders that was not to be sold. Notwithstanding this. Sandars sold it to secure his advance. In an action against him, Sandars piE the agency was irrevocable. Decide

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				

12.12 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 13: Law of Sales of Goods

Notes

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 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.

Notes

13.1 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 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.

13.2 Contract of Sale

Notes

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.

13.3 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 lakh. 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.

Notes

Sale and Agreement to Sell–distinction

1. ***Transfer of property:*** In a sale, the property in the goods passes from the seller to the buyer immediately so that the seller is no more the owner of the goods sold. In an agreement to sell, the transfer of property in the goods is to take place at a future time or subject to certain conditions to be fulfilled. In this sense, a sale is an executed contract and an agreement to sell is an executory contract.
2. ***Type of goods:*** A sale can only be in case of existing and specific goods only. An agreement to sell is mostly in case of future and contingent goods although in some cases it may refer to unascertained existing goods.
3. ***Risk of loss:*** In a sale, if the goods are destroyed, the loss falls on the buyer even though the goods are in the possession of the seller. In an agreement to sell, if the goods are destroyed, the loss falls on the seller, even though the goods are in the possession of the buyer.
4. ***Consequences of breach:*** In a sale, if the buyer fails to pay the price of goods or if there is a breach of contract by the buyer, the seller can sue for the price even though the goods are still in his possession. In an agreement to sell if there is a breach of contract by the buyer, the seller can only sue for damages and not for the price even though the goods are in the possession of the buyer.
5. ***Right to re-sell:*** In a sale, the seller cannot re-sell the goods (except in certain cases, as for example, a sale by a seller in possession after sale under Sec.30, or a sale by an unpaid seller under Sec. 54). If he does so the subsequent buyer does not acquire title to the goods. In an agreement to sell, in case of re-sale, the buyer, who takes the goods for consideration and without notice of the prior agreement, gets a good title. In such a case, the original buyer can only sue the seller for damages.
6. ***General and particular property:*** A sale is contract plus conveyance, and creates *jus in rem*, i.e., gives right to the buyer to enjoy the goods as against the world at large including the seller. An agreement to sell is merely a contract, pure and simple and creates *jus in personam*, i.e., gives a right to the buyer against the seller to sue for damages.
7. ***Insolvency of buyer:*** In a sale, if the buyer becomes insolvent before he pays for the goods, the seller, in the absence of a lien over the goods, must return them to the official Receiver or Assignee. He can only claim a rateable dividend for the price of the goods. In an agreement to sell, if the buyer becomes insolvent and has not yet paid the price, the seller is not bound to part with the goods until he is paid for.
8. ***Insolvency of seller:*** In a sale, if the seller becomes insolvent, the buyer, being the owner, is entitled to recover the goods from the Official Receiver or Assignee. In an agreement to sell, if the buyer, who has paid the price, finds that the seller has becomes insolvent, he can only claim a rateable dividend and not the goods because property in them has not yet passed to him.

13.4 Goods and their Classification

13.4.1 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.

Notes

13.4.2 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.

13.5 Meaning of Price

13.5.1 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.

13.5.2 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.

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.

Notes

13.6 Passing of Property in Goods

13.6.1 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.

13.6.2 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.

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.

13.7 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.

Notes

- 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.

13.8 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.

13.9 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.
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.

13.10 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?

Notes

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?
8. A dentist makes a set of false teeth for his patient with materials wholly found by the dentist and the buyer agrees to pay ₹ 3000 when they are properly fitted into his mouth.
9. A customer gives his tailor a length of suiting and requires him to make a suit for him, the lining materials and buttons to be supplied by the tailor.
10. A wholesale dealer in soaps agrees to sell and deliver two cases of 'Luxury' toilet soap to a sub-dealer but delivers that quantity of 'Luxury' washing soap. What are the rights of the sub-dealer?
11. A lady who knew that she was allergic to a particular hair dye developed dermatitis as a result of having her hair dyed with that substance. She did not disclose her allergy to the hair dresser. Is the hair dresser liable for breach of implied condition?
12. Ravi sold to Manish a tin of disinfectant powder. He knew that it would be dangerous to open the tin without special care but he did not warn Manish. Manish without knowledge of the danger, opened the tin whereupon the powder flew into his eyes and injured him. Manish filed a suit for damages for the injury. Will he succeed?

Answers: Self Assessment

1.	True	2.	False	3.	True	4.	False
5.	True	6.	False	7.	True	8.	True
9.	False						

13.11 Further Readings

Books

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

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Unit 14: Remedies of Unpaid Seller

Notes

CONTENTS

Objectives

After studying this unit, you will be able to:

- Explain unpaid seller and his rights
- Discuss remedies of breach of contract

Introduction

In last unit you have studied about law of goods. Indian business persons, conducting their businesses 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 businesses, such as F.O.B. (free on board), C.I.F. (cost, insurance and freight) and ex-ship. In this unit you will learn about the knowledge of transfer of Title.

'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.

14.1 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.

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.

Notes

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:

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.

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.

(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.

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.

14.2 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).

Notes

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.

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.

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.

Buyer's Remedies against Seller

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).

14.3 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.

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14.4 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.

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.

14.5 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.

14.6 Review Questions

1. Define an unpaid seller. What are the different rights of an unpaid seller?
2. Distinguish between the right of lien and stoppage in transit.
3. State the circumstances when the right of stoppage in transit ends.
4. When can a seller resell the goods?
5. What remedies are available to a seller for breach of contract of sale?
6. Discuss the buyer's remedies against seller where there is a breach of contract.
7. State the law which governs the sale of goods by auction.
8. Mr. Gupta sold a quantity of wheat to Mr. Verma, who paid by cheque which was dishonoured upon presentation, Mr. Gupta gave a delivery order to Mr. Verma for the wheat and Mr. Verma resold it to Sahil , purchaser in good faith, for consideration indorsing the delivery order to him. Mr. Gupta refuses to deliver the goods to Sahil on the plea of non-receipt of price. Advise Sahil.
9. Rahul sells and consigns goods to Ravi of the value of ₹ 10,000. Ravi assigns the bill of lading for these goods to Roshan to secure the sum of ₹ 4,000 due from him to Roshan, Ravi becomes insolvent. Can Rahul stop the goods in transit?
10. Goods were sold and sent by the sellers at the request of the buyer to shipping agents of the buyer and were put on board a ship by those agents. Subsequently they were re-landed and

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sent back to the sellers for the purpose of re-packing. While they were still in the possession of the sellers for that purpose, the buyer became insolvent. The sellers refused to deliver them to the Official Receiver except upon payment of the price. Are the sellers entitled to refuse to deliver the goods to the Official Receiver? State reasons for your answer.

11. Ram sold goods to Shankar and forwarded to Shankar the bill lading indorsed in blank together with a draft for the price for acceptance. Shankar, who was insolvent, did not accept the draft but transferred the bill of lading to Raman, who took it in good faith and for value. The seller stopped the goods in transit. Discuss the rights of Raman as against the goods.

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		

14.7 Further Readings

Books

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

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http://www.vakilno1.com/bareacts/saleofgoods/saleofgoods.htm

Notes

Unit 15: Conditions and Warranties

CONTENTS

Objectives

After studying this unit, you will be able to:

- Discuss conditions and warranties
- Explain express and implied conditions and warranties

Introduction

As you all know that before a contract of sale is entered into, a seller frequently makes representations or statements with reference to the goods which influence the buyer to clinch the bargain. Such representations or statements differ in character and importance. Whether any statement or representation made by the seller with reference to the goods is a stipulation forming part of the contract or is a mere representation (such as expression of an opinion) forming no part of the contract, depends on the construction of the contract. If there are no such representations, the ordinary rule of law - *caveat emptor',* i.e., "let the buyer beware" --applies. This means the buyer gets the goods as they come and it is no part of the seller's duty to point out the defects in the goods to the buyer.

15.1 Conditions and Warranties

A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty [Sec. 12 (1)].

Condition [Sec. 12 (2)]. A *condition* is a stipulation which is *essential to the main purpose of the contract.* It goes to the root of the contract. Its non-fulfilment up sets the very basis of the contract. It is defined by Fletcher Moulton L.J. in *Wallis* v. *Pratt,* (1910) 2 K.B. 1012 as an "obligation which goes so directly to the substance of the contract or, in other words, is so essential to its very nature, that its non-performance may fairly be considered by the other party as a substantial failure to perform the contract at all." If there is a breach of a condition, the aggrieved party can treat the contract as repudiated.

Notes

Example: By a charter party (a contract by which a ship is hired for the carriage of goods), it was agreed that ship M of 420 tons "now in the port of Amsterdam" should proceed direct to Newport to load a cargo. In fact at the time of the contract the ship was not in the port 6f Amsterdam and when the ship reached Newport, the charterer refused to load. *Held,* the words "now in the port of Amsterdam" amounted to a condition, the breach of which entitled the charterer to repudiate the contract [*Behn* v. *Burness,* (1863) 3 B. & S. 751].

Warranty [Sec. 12(3)]. A *warranty* is a stipulation which is *collateral to the* main *purpose* of *the contract.* It is not of such vital importance as a condition is. It is defined in *Wallis* v. *Pratt* as an, "obligation which, though it must be performed, is not so vital that a failure to perform it goes to the substance of the contract." If there is a breach of a warranty, the aggrieved party can only claim damages and it has no right to treat the contract as repudiated. Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract as a whole .. The Court is not to be guided by the terminology used by the parties to the contract. A stipulation may be a condition though called a warranty in the contract [Sec. 12(4)].

Distinction between a Condition and a Warranty

1. ***Difference as to value.*** A condition is a stipulation which is essential to the main purpose of the contract. A warranty is a stipulation which is collateral to the main purpose of the contract.
2. ***Difference as to breach.*** If there is a breach of a condition, the aggrieved party can repudiate the contract of sale; in case of a breach of a warranty, the aggrieved party can claim damages only.
3. ***Difference as to treatment.*** A breach of a condition may be treated as a breach of a warranty. This would happen where the aggrieved party is contented with damages only. A breach of a warranty, however, cannot be treated as a breach of a condition.

When condition to be treated as warranty (Sec. 13)

1. ***Voluntary waiver of condition.*** Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may (a) waive the condition, or (b) elect to treat the breach of the condition as a breach of warranty [Sec. 13(1)]. If the buyer once decides to waive the condition, he cannot afterwards insist on its fulfilment.
2. ***Acceptance of goods by buyer.*** Where a 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, unless there is a term of the contract, express or implied, to the contrary [Sec. 13(2)].

The provisions of Sec. 13 do not affect the cases where the fulfilment of any condition, or warranty is excused by law by reason of impossibility or otherwise [Sec. 13(3)].

15.2 Express and Implied Conditions and Warranties

In a contract of sale of goods conditions and warranties may be express or implied. Express conditions and warranties are those which are expressly provided in the contract. Implied conditions and warranties (contained in Secs. 14 to 17) are those which the law implies into the contract unless the parties stipulate to the contrary. Sec. 16(4) further provides that an express warranty or condition does not negative an implied warranty or condition unless the express warranty or condition is inconsistent with the implied warranty or condition.

Notes

Implied Conditions

Condition as to title [Sec. 14 (a)]. In a contract of sale, unless the circumstances of the contract are such as to show a different intention, there 'is an implied condition on the part of the seller that-

(a) In *the case of* a *sale,* he has a *right to sell* the goods, and

(b) In *the case of* an *agreement to sell,* he will have a *right to sell* the goods at the time when the property is to pass.

Example: R bought a car from D and used it for four months. D had no title to the car and consequently *R* had to hand it over to the true owner. Held, *R* could recover the price paid [*Rowland* v. *Divall,* (1923) 2 K.B. 500].

If the goods delivered can only be sold by infringing a trade mark, the seller has broken the condition that he has a right to sell the goods. The expression "right to sell" is wider than the "right to property" .

Example: A bought 3,000 tins of condensed milk from the U.S.A. The tins were labelled in such a way as to infringe the Nestle's trade mark. As a result, they were detained by the custom authorities. To get the clearance certificate from the custom authorities, A had to remove the labels and sell the tins at a loss. *Held,* the seller had broken the condition that he had the right to sell [*Niblett Ltd.* v. *Confectioners' Materials Co.,* (1921) 3 K.B. 387].

Where a seller having no title to the goods at the time of the sale, subsequently acquires a title, that title feeds the defective titles of both the original buyer and the subsequent buyer [*Butterworth* v. *Kingsway Motors,* (1954) 1 W.L.R. 1286].

Sale by description (Sec. 15). Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description. The rule of law contained in Sec. 15 is summarised in the following maxim: "If you contract to sell peas, you cannot oblige a party to take beans. If the description of the article tendered is different in any respect, it is not the article bargained for and the other party is not bound to take it". [*Bowes* v. *Shand,* (1877) App. Cas. 455].

Goods are sold by description when they are described in the contract, as Farm wheat or Dehra Dun Basmati, and the buyer contracts in reliance on that description.

Example: A ship was contracted to be sold as a 'copper-fastened vessel' to be taken with all faults, without any allowance for any defects whatsoever. The ship turned out to be 'partially copper-fastened'. *Held,* the buyer was entitled to reject [*Shepherd* v. *Kain,* (1821) 5 B. & Ald. 240.]

'Sale of goods by description' may include the following situations:

(1) Where the buyer has not seen the goods and relies on their description given by the seller.

Example: W bought a reaping machine which he had never seen and which, V, the seller, described "to have been new the previous year and used to cut only 50 or 60 acres". W found the machine to be extremely old. Held, W could return the machine as it did not correspond with the description [*Varley* v. *Whipp,* (1900) Q.B. 513].

(2) Where the buyer has seen the goods but he relies not on what he has seen but what was stated to him and the deviation of the goods from the description is not apparent.

Notes

Examples: (a) In an auction sale of a set of napkins and table cloths, these were described as 'dating from the seventh century'. The buyer bought the set after seeing it. Subsequently he found the set to be an eighteenth century set. Held, he could reject the set *[Nicholson* & *Venn* v. *Smith Marriott.* (1947) 177 L.T. 189].

(b) A car was advertised for sale as a "Herald Convertible, 1961 model". The buyer saw the car before buying it. After buying the car, he discovered that while the rear part of the car was part of a 1961 model, the front half was part of an earlier model. Held, he could return the car [Beale v. *Taylor,* (1967) 3 All E.R 253].

(3) Packing goods may sometimes be a part of the description.

Example. M sold to L 300 tins of Australian fruits packed in cases each containing 30 tins. M tendered a substantial portion in cases containing 24 tins. Held, L could reject all the tins as the goods were not packed according to the description given in the contract as the method in which the fruit was packed was an essential part of the description [*Moore & Co. v. Landauer & Co.*, (1921) 2 K.B. 519].

Sale by description as well as by sample. Sec. 15 further provides that if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description. This means the goods must correspond both with the sample and with the description.

Examples. (a) In a contract for the sale of a quantity of seed described as "Common E!1glish Sainfoin", the seed supplied was of a different kind, though the difference was not discoverable except by sowing. The defect also existed in the sample. *Held,* the buyer was entitled to recover damages for the breach of condition [*Wallis* v. *Pratt,* (1911) A.C. 394].

(b) N agreed to seil to G some oil described as "foreign refined rape oil, warranted only equal to sample". The goods tendered were equal to sample, but contained an admixture of hemp oil. *Held,* G could reject the goods [*Nichol* v. *Godts,* (1854) 10 Ex. 191].

3. ***Condition as to quality or fitness [Sec. 16 (1)].*** Normally, in a contract of sale there is no implied condition as to quality or fitness of the goods for a particular purpose. The buyer must examine the goods thoroughly before he buys them in order to satisfy himself that the goods will be suitable for the purpose for which he is buying them. The following points should, however, be noted in this regard:

(1) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which he needs the goods and depends upon the skill and judgment of the seller whose business it is to supply goods of that description, there is an implied condition that the goods shall be reasonably fit for that purpose [Sec. 16 (1)].

Example. An order was placed for some lorries to be used "for heavy traffic in a hilly area". The lorries supplied were unfit and break down. There is breach of condition as to fitness.

(2) If the buyer purchasing an article for a particular use is suffering from an abnormality and it is not made known to the seller at the time of sale, implied condition of fitness does not apply.

Example. G purchased a tweed coat which caused her dermatitis (inflammations of the skin) due to her unusually sensitive skin. *Held,* the seller was not liable, the cloth being fit for anyone with a normal skin [*Griffiths* v. *Peter Conway Ltd.,* (1939) 1 All E.R. 685].

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(3) If the buyer purchases an article under its patent or other trade name, the implied condition that articles are fit for a particular purpose shall not apply, unless the buyer relies on the seller's skill and judgment and makes known to the seller that he so relies on him.

Example. B told M, a motor car dealer, that he wanted a comfortable car suitable for touring purposes. M recommended a 'Bugatti car' and B thereupon bought one. The car was uncomfortable and unsuitable for touring purposes. *Held,* B could reject the car and recover the price, and the mere fact that B bought the car under its trade name did not necessarily exclude the condition of fitness *[Baldry* v. *Marshall,* (1925) 1 K.B. 260].

(4) In case the goods can be used for a number of purposes, the buyer must tell the seller the particular purpose for which he requires the goods. If he does not, he cannot hold the seller liable if the goods do not suit the particular purpose for which he buys the goods.

Example. A, a woollen merchant who was also a tailor, bought, by a sample, indigo cloth for the purpose of making *liveries.* This fact was not brought to the notice of the seller. *Held,* the seller was not liable when, on account of a latent defect in the cloth, the cloth was unfit for making liveries, but was fit for other usual purposes [*Jones v. Padgett,* (1890) 24 Q.B.D. 650].

4. **Condition as to merchantability** [Sec. 16 (2)]. Where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods are of merchantable quality. This means goods should be such as are commercially saleable under the description by which they are known in the market at their full value.

The term 'merchantable' quality is not defined in the Sale of Goods Act. But according to Sec. 62 (l-A) of the English Sale of Goods Act, 1893, "Goods of any kind are of merchantable quality if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect *having* regard to any description applied to them, the price (if relevant) and all the other relevant circumstances."

Example: A firm of Liverpool merchants contracted to buy from a London merchant a number of bales of Manilla hemp to *arrive* from Singapore. The hemp was damaged by sea water in such a way that it would not pass in the market as Manilla hemp. *Held,* the goods were not of merchantable quality [*Jones v. Just,* (1868) L.R. 3 Q.B. 197].

If goods are of such a quality and in such a condition that a reasonable person acting reasonably would accept them after *having* examined thoroughly, they are of merchantable quality. Thus a watch that will not keep time, a pen that will not write, and tobacco that will not smoke, cannot be regarded as merchantable under such names.

Example: (a) A manufacturer supplied 600 horns under a contract. The horns were found to be dented, scratched and otherwise of faulty manufacture. *Held,* they were not of merchantable quality and therefore the seller's suit for price WpS dismissed [*Jackson v. Rutax Motor* & *Cycle Co.,* (1910) 2 K.B. 397].

(b) There was a sale by a grocer of tinned salmon which was poisonous. It resulted in the death of the wife of the buyer. *Held,* the buyer could *recover* damages including a sum to compensate him for being compelled to hire services which were rendered by his wife *[Jackson* v. *Watson* & *Sons,* (1909) 9 K.B. 193 c.A.].

(c) P sold a plastic catapult *to* G, a boy of six. While G was using it in the proper manner, the catapult broke due to the fact that ti1e material used in its manufacture was unsuitable. As a

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result, the boy was blinded in one eye. *Held,* P was liable as the catapult was not of merchantable quality [*Cod ley v. Perry,* (1960) *I* All E.R. 36].

(d) A radio set was sold *to* a layman. The set was *defective.* It did not work in spite of repairs. *Held,* the buyer could return the set and claim refund *[R.S. Thakur v. H.G.£. Corpn.,* A.l.R. (1971) Bom. 97].

Even if the defect can be easily cured, e.g., by washing an irritant out of a woollen or nylon garment by making some trifling repair, the buyer can *avoid* the contract. If he has examined the goods, there is no implied condition as regards defects which such examination ought to *have* revealed. If, while professing to examine the goods, he makes a perfunctory examination with the result that he overlooks a defect which a proper examination would *have revealed,* he has nevertheless examined the goods, and there will be no implied condition of merchantable quality.

Example: B went to V's warehouse to buy some glue. The glue was stored in barrels and every facility was *given* to B for its inspection. B did not *have* any of the barrels opened, but only looked at the outside. He then purchased the glue. *Held,* as an examination of the inside 01 the barrels would have revealed the nature of the glue, and as B had an opportunity of making the examination, there was no condition as to merchantable quality *[Thornett* & *Fehr* v. *Beers & Sons,* (1919) 1 KB. 486].

Packing of the goods is an equally important consideration in judging their 'merchantability'.

Example: M asked for a bottle of Stone's ginger wine at *F's* shop, which was licensed for the sale of wines. While M was drawing the cork, the bottle broke and M was injured. *Held,* the sale was by description and M was entitled to recover damages as the bottle was not of merchantable quality *[Morelli* v. *Fitch* & *Gibbons,* (1928) 2 KB. 636].

Where the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed [Proviso to Sec. 16 (2)].

5. ***Condition implied by custom.*** An implied condition as to quality or fitness for a particular purpose may be annexed by the usage of trade [Sec. 16 (3)].

In some cases, the purpose for which the goods are required may be ascertained from the acts and conduct of the parties to the sale, or from the nature of description of the article purchased. For instance, if a perambulator or a bottle of milk is purchased, the purpose for which it is purchased is implied in the thing itself. In such a case, the buyer need not tell the seller the purpose for which he buys the goods.

Example: (a) P asked for a hot water bottle of *L,* a retail chemist. He was supplied one which burst after a few days use and injured P's wife. *Held, L* was liable for breach of implied condition because P had sufficiently made known the use- for which he required the bottle [*Priest v. Last,* (1903) 2 KB. 148].

(b) G purchased a woollen underwear from M, a retailer, whose business was to sell goods of that description. After wearing the underwear, G developed an acute skin disease. *Held* the goods were not fit for their only proper use and G was entitled to avoid the contract and claim damages [*Grant v. Australian Knitting Mills Ltd.,* (1936) A.C. 5].

(c) A bought a set of false teeth from a dentist. The set did not fit into A's mouth. *Held* he could reject the set as the purpose for which anybody would buy it was implicitly known to the seller, i.e., the dentist [*Dr. Baretto v. T.R. Price*, AIR (1939) Nag. 19].

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6. ***Sale by sample (Sec. 17).*** A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect [Sec. 17 (1)]. In the case of a contract for sale by sample, there is an implied condition:

(a) that the bulk shall correspond with the sample in quality; (b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample. (c) that the goods shall be free from any defect, rendering them unmerchantable. The defect should not however be apparent on a reasonable examination of the sample [Sec. 17 (2)]. This implied condition applies only to latent defects, i.e., defects which are not discoverable on a reasonable examination of the sample. The seller is not responsible for the defects which are *patent,* i.e., visible or discoverable by examination of the goods. In case of patent defects, there is no breach of implied condition as to merchantability.

Example: (a) There was a sale by sample of mixed worsted coatings to be in quality and weight equal to the samples. It was found that the goods owing to a latent defect would not stand ordinary wear when made up into coats. The same defect was there in the sample but could not be detected on a reasonable examination of the sample. *Held,* the buyer could reject the goods [*Drummond* v. *Van Ingen,* (1887) 12 App. Cas. 284]. The office of the sample is to present to the eye the real meaning and intention of the parties with regard to the subject matter of the contract which, owing to the imperfection of language, it may be difficult or impossible to express in words. The sample speaks for itself." *(Lord Macnaghten).*

(b) In a contract for the sale of brandy by sample, brandy coloured with a dye was supplied. *Held,* the buyer was not bound to the contract even though the goods supplied were equal to sample, as the defects were not apparent on reasonable examination of sample [*Mody* v. *Gregson,* (1868) L.R. 4 Ex. 49].

(c) D sold sulphuric acid to P as commercially free from arsenic. P *used* it for making glucose which he sold to brewers who used it in brewing beer. The persons who drank the beer were poisoned. D was not aware of the purpose for which P had bought the acid. *Held,* P was entitled to repudiate the contract and since this was not possible in the instant case (as P had already used the goods), he could treat breach of condition as breach of warranty and claim damages [*Bostock* & Co. *Ltd.* v. *Nicholson* & *Sons Ltd.,* (1904) 1 KB. 725].

7. ***Condition as to wholesomeness.*** In the case of eatables and provisions, in addition to the implied condition as to merchantability, there is another implied condition that the goods shall be wholesome.

Example: (a) F bought milk from A. The milk contained germs of typhoid fever. F's wife took the milk and got infection as a result of which she died. *Held,* F could recover damages *[Frost* v. *Aylesbury Dairy Co. Ltd.,* (1905) 1 KB. 608].

(b) C bought a bun containing a stone which broke one-of C's teeth. *Held,* he could recover damages [*Chaproniere v. Mason,* (1905) 21 T.L.R. 633].

Implied Warranties

The implied warranties in a contract of sale are as follows :

1. ***Warranty of quiet possession [Sec. 14 (b)].*** In a contract of sale, unless there is a contrary intention, there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods. If the buyer is in any way disturbed in the enjoyment of the goods in consequence of the seller's defective title to sell, he can claim damages from the seller.

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2. ***Warranty of freedom from encumbrances [Sec. 14 (c)].*** In addition to the previous warranty, the buyer is entitled to a further warranty that the goods are not subject to any charge or right in favour of a third party. If his possession is in any way disturbed by reason of the existence of any charge or encumbrance on the goods in favour of any third party, he shall have a right to claim damages for breach of this warranty.

3. ***Warranty as to quality or fitness by usage of trade [Sec. 16 (4)].*** An implied warranty as to quality or fitness for a particular purpose may be annexed by the usage of trade.

4. ***Warranty to disclose dangerous nature of goods.*** Where a person sells goods, knowing that the goods are inherently dangerous or they are likely to be dangerous to the buyer and that the buyer is ignorant of the danger, he must warn the buyer of the probable danger, otherwise he will be liable in damages.

Example: A sold a 'tin of disinfectant powder to C. He knew that it was likely to be dangerous to C if it was opened without special care being taken. C opened the tin where upon the disinfectant powder flew into her eyes, causing injury. *Held,* A was liable in damages to C, as he should have warned C of the probable danger [*Clarke* v. *Army* & *Navy Co-operative Society Ltd.,* (1963) 1 K B. 155].

Exclusion of implied conditions and warranties. Implied conditions and warranties in a contract of sale may be negative or varied by (a) express agreement between the parties; or (b) the course of dealing between them; or (c) the custom or usage of trade.

15.3 Caveat Emptor

This means 'let the buyer beware', i.e., in a contract of sale of goods the seller is under no duty to reveal unflattering truths about the goods sold. Therefore, when a person buys some goods, he must examine them thoroughly. If the goods turn out to be defective or do not suit his purpose or if he depends upon his own skill or judgment and makes a bad selection, he cannot blame anybody excepting himself.

Examples: (a) H bought oats from S a sample of which had been shown to H. H erroneously thought that the oats were old. The oats were, however, new. *Held,* H could not avoid the contract *[Smith* v. *Hughes,* (1871) **L.R.** 6 Q.B. 597).

(b) H sent to market 32 pigs to be sold by auction. The pigs were sold to W "with all faults and errors of description". H knew that the pigs were suffering from swine-fever, but he never disclosed this to W. *Held,* there was no implied warranty by H and the sale was good and H was not liable in damages [*Ward* v. *Hobbs,* (1878) 4 App. Cas 13]. The rule of *caveat* emptor is enunciated in the opening words of Sec. 16 which runs thus: "*Subject to the* provisions *of this Act and of any other* law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale ... "

Exceptions. The doctrine of *caveat emptor* has certain important exceptions. The case law on these exceptions has already been discussed.

The exceptions are however briefly referred to:

1. **Fitness *for buyer's purpose.*** Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which he requires the goods and relies on the seller's skill or judgment and the goods are of a description which it is in the course of the seller's business to supply, the seller must supply the goods which, shall be fit for the buyer's purpose [Sec. 16 (1)].

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2. ***Sale under a patent or trade name.*** In the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition that the goods shall be reasonably fit for any particular purpose [Proviso to Sec. 16 (1)].

3. ***Merchantable quality.*** Where goods are bought by description from a seller *who* deals in goods of that description (whether he is the manufacturer or producer or not), there is an implied condition that the goods shall be of merchantable quality. But if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed [Sec. 16 (2)].

4. ***Usage of trade.*** An implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade [Sec. 16(3)].

5. ***Consent by fraud.*** Where the consent of the buyer, in a contract of sale, is obtained by the seller by fraud or where the seller knowingly conceals a defect which could not be discovered on a reasonable examination (i.e., where there is a latent defect in the goods), the doctrine of *caveat* emptor does not apply.

15.4 Summary

A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty [Sec. 12 (1)]. A condition is a stipulation essential to the main purpose of the contract. In a contract of sale, conditions and warranties may be express or *implied.* Express conditions and warranties are those which are agreed upon between the parties at the time of the contract. Implied conditions and warranties are those which are implied by law unless the parties stipulate to the contrary. Its breach gives a right to the buyer to treat the contract as repudiated [Sec. 12 (2)]. A warranty is a stipulation collateral to the main purpose of the contract. Its breach gives rise to claim for damages but not a right to reject the goods and treat the contract as repudiated [Sec. 12 (3)].

The condition as to quality or fitness is implied where (a) the goods sold are such as the seller deals in the ordinary course of his business; (b) the buyer relies on the seller's skill or judgment as to the fitness of the goods for any particular purpose; and (c) the buyer expressly or impliedly makes known to the seller that he wants the goods for that particular purpose [Sec. 16 (1)]. An implied condition as to quality or fitness for a particular purpose may be annexed by the usage of trade. In the case of a contract for sale by sample there are few implied conditions (a) that the bulk shall correspond with the sample in quality; (b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample; and (c) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on a reasonable examination of the sample (Sec. 17).

15.5 Keywords

Condition: A condition is a stipulation essential to the main purpose of the contract. Its breach gives a right to the buyer to treat the contract as repudiated [Sec. 12 (2)].

Warranty: A warranty is a stipulation collateral to the main purpose of the contract. Its breach gives rise to a claim for damages but not a right to reject the goods and treat the contract as repudiated [Sec. 12 (3)].

Implied warranties. In a contract of sale, unless there is a contrary intention, there is an implied warranty that (1) the buyer shall have and enjoy quiet possession of the goods [Sec. 14 (b)], and (2) the goods are free from any charge or encumbrance in favour of any third party [Sec. 14 (c)].

15.6 Self Assessment

Notes

State whether the following statements are true or false:

1. If there is breach of condition, the aggrieved party can only claim damages and it has not the right to repudiate the contract.
2. If a buyer once waives a condition, he cannot afterwards insist on its fulfillment.
3. In a sale by sample as well as by description, the goods must correspond both with the sample and the description.
4. In a contract of sale, there is no implied conditions as to quality or fitness of the goods for a particular purpose.
5. Packing of goods is not an important consideration in judging their 'merchantability'.
6. Where a person sells goods, knowing that the goods are dangerous to the buyer and that the buyer is ignorant of the danger, he need not warn the buyer of the probable danger.
7. An article is sold under its patent name. There is no implied condition that the goods shall be reasonably fit for any particular purpose.
8. In a contract of sale by sample, the bulk of goods supplied may not correspond with sample.
9. An implied condition to quality may be annexed by the usage of trade.
10. If the buyer has examined the goods there is no implied condition as regards defects which such examination ought to have disclosed.

15.7 Review Question

1. Discuss the conditions and warranties implied by law in a contract for the sale of goods.
2. "If a person sells an article, he thereby warrants that it is fit for some purpose, but he does not warrant that it is fit for any particular purpose." State the various qualifications subject to which this proposition should be received.
3. State the conditions implied in a contract for the sale of goods (a) by description, (b) by sample, and required for a particular purpose.
4. What is implied 'warranty' in case of a sale by sample? Can a contract be avoided if such warranty is breached?
5. A purchases some chocolates from a shop. One of the chocolates contains a poisonous matter and as a result A's wife who has eaten it falls seriously ill. What remedy is available to A against the shopkeeper?

   [*Hint:* The chocolates are not of merchantable quality and hence A can repudiate the contract and recover damages (Sec. 16 (2)]
6. Worsted cotton cloth of quality equal to sample was sold to tailors who could not stick it into coats owing to some defect in its texture. The buyers had examined the cloth before effecting the purchase. Are they entitled to damages?

   [*Hint:* Yes, as there is a latent defect in cloth (Sec. 17; *Drummond* v. *Van Ingen).*]

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7. M asked for a bottle of Stone's Ginger Wine at *F's* shop which was licensed for the sale of wines. While M was drawing the cork, the bottle broke because of defect in the glass and M was injured. Can M claim damages for the injury?

   [*Hint:* Yes, as the bottle is not of merchantable quality and there is a sale of goods by description (Secs. 15 and 16 (2) ; *Morelli* vs.. *Fitch and Gibbons*)].

8. A seller agrees to supply to the buyer timber of 1/2" thickness for being made into cement barrels. The timber actually supplied varies in thickness from 1/2" to 5/8". The timber is merchantable and commercially fit for the purpose for which it was ordered. The buyer rejects the timber. Is this action justified?

   [*Hint:* Yes (Sec. 15)]

9. The sale of pure ghee was warranted only equal to sample. The ghee tendered corresponded to the sample, but was adulterated with 25% groundnut oil. Are the buyers bound to accept?

   [*Hint:* No (Sec. 17).]

10. A lady buys synthetic pearls for a high price thinking that they are natural pearls. The seller does not correct her mistake. Has she any remedies against the seller? Would your decision be different if the lady had told the seller; "I think they are natural pearls and, therefore, agree to buy them at your price," and the seller was silent?

    [*Hint*: The lady has no remedy against the seller as the doctrine of *caveat emptor* applies in this case. [In the latter case, she can void the contract as there is a breach of condition as to quality (Sec. 16 (1).]

11. A wholesale dealer in soaps agrees to sell and deliver two cases of *'Luxury'* toilet soap to a sub-dealer but delivers that quantity of *'Luxury'* washing soap. What are the rights of the sub-dealer?

Answer : Self Assessment

1.	False;	2.	True;	3.	True;
4.	True;	5.	False;	6.	False;
7.	True;	8.	False;	9.	True;
10.	True				

15.8 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.

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Online links http://webarchive.nationalarchives.gov.uk/+/http://www.berr.gov.uk/whatwedo/consumers/fact-sheets/page38311.html

http://www.dateyvs.com/gener12.htm

http://www.sudhirlaw.com/Business3.html

http://www.vakilno1.com/bareacts/saleofgoods/saleofgoods.htm

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Unit 16: The Consumer Protection Act

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Objectives

After studying this unit, you will be able to:

- Define important terms related to consumer
- Explain rights of consumers
- Analyze the remedies available for consumer

Introduction

In the earlier unit, you came to know about the law of contacts of sale. In this unit you will study about the Consumer Protection Act.

The Consumer Protection Act, 1986 was born. It is described as a unique legislation of its kind ever enacted in India to offer protection to the consumers. The Act is claimed to have been designed after an in-depth study of consumer protection laws and arrangements in UK, the USA, Australia and New Zealand. The main objective of this Act is to provide better protection to the consumers. Unlike other laws, which are punitive or preventive in nature the provisions of this Act are compensatory in nature. The Act intends to provide simple, speedy and inexpensive redressal to the consumers' grievances.

16.1 Important Terms

The Preamble to the Act spells out its objects in the following words: "An Act to provide for better protection of the interests of consumers and for that purpose to make provision for the establishment of consumer councils and other authorities for the settlement of consumers' disputes and for matters connected therewith."

Thus, the objects of the Consumer Protection Act are:

1. To provide for better protection of interests of consumers.
2. In order to meet the aforesaid objective, to provide for the establishment of consumer councils and other authorities
3. To empower the Consumer Councils and other authorities to settle consumers' disputes and matters connected therewith.

Other salient features of the Act are:

1. It applies to all goods and services unless specifically exempted by the Central Government.
2. It covers all sectors whether private, public or co-operative.
3. It confers certain rights on consumers.
4. It envisages establishment of consumer protection councils at the Central and State levels whose main object shall be to promote and protect the rights of the consumers.
5. The provisions of this Act are in addition to and not in derogation of the provisions of any other Act.

Note The Act in terms of geographical application extends to the whole of India except the State of Jammu and Kashmir [S.1(2)]. Further, it applies to all goods and services, unless otherwise expressly notified by the Central Government.

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The Consumer Protection Act, 1986 was substantially amended in 1991, 1993 and 2002.

Complainant. A complainant means any of the following and having made a complaint:

1. a consumer; or
2. any voluntary consumer association registered under the Companies Act, 1956 or under any other law for the time being in force; or
3. the Central Government or any State Government; or
4. one or more consumers, where there are numerous consumers having the same interest, or
5. in case of death of consumer, his legal heir or representative.

Complaint. 'Complaint' means any allegation in writing made by a complainant with a view to obtaining any relief under the Act, that:

1. any unfair trade practice or restrictive trade practice has been adopted by any trader or service provider; and the complainant has suffered loss or damage;
2. the goods bought by him or agreed to be bought by him suffer from defect(s) in any respect.
3. the services hired or availed of or agreed to be hired or availed of by him suffer from deficiency in any respect;
4. a trader or the service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price (a) fixed by or under any law for the time being in force; (b) displayed on the goods or any package containing such goods; (c) displayed on the price list exhibited by him by or under any law for the time being in force; (d) agreed between the parties;
5. goods which will be hazardous to life and safety when used are being offered for sale to the public (a) in contravention of any standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force; (b) if the trader could have known with due diligence that the goods so offered are unsafe to the public;

Consumer. 'Consumer' means any of the following persons:

1. A person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised or under any system of deferred payment i.e., in respect of hire-purchase transactions. The term includes any other user of such goods when such use is made with the approval of the buyer.
2. A person who hires or avails of any services for consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment. The term includes any other beneficiary of such services with the approval of the first mentioned person.

Example: Byford Motors inserted an advertisement in newspapers stating that a person booking a Premier Padmini car could enter into a contest in a lottery conducted by them. Under it, a person who was successful in the draw could be entitled to two free tickets from New Delhi to New York and back. Shri S.S. Srivastava was one of the persons who was successful in the draw. He asked the dealers to give him the value of two tickets which was refused and he was asked to produce two passports to enable them to book the tickets. Mr. Srivastava, however, produced one passport immediately but the second after the end of the financial year. The dealer refused to give the tickets on the ground that the accounts of the financial year had been closed and they could not carry forward the liability of that year to the next financial year under the provisions of the Income-tax Act and Rules.

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The contention of the dealer is correct. Mr. Srivastava is not a consumer. He has received the car for which he has paid and there is no complaint as to any defect therein. The announcement of free air tickets to New York was an additional attraction attached to the sale which depended upon a lottery draw. It is not an intrinsic part of the car sale deal for which he made the payment. Thus, as far as the lottery was concerned, it could not be said that Mr. Srivastava was a consumer.

Consumer dispute [Sec.2(1)(c)]. It means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint.

Task S admitted his only infant son in a private nursing home. As a result of strong dose of medicine administered by the nursing attendant, the child became mentally retarded. S wants to make a complaint to the district forum seeking relief by way of compensation on the ground that there was deficiency in service by the nursing home. Does his complaint give rise to a consumer dispute? Who is the consumer in the instant case? [*Hint:* Yes, this complaint gives rise to a consumer dispute. S is a consumer who hires the services of the nursing home. Also the infant is a beneficiary and therefore he is also a consumer.]

Defect [Sec.2(1)(f)]. A 'defect' is defined to mean any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied, or as is claimed by the trader in any manner whatsoever in relation to any goods.

Deficiency. Parallel to 'defect' in case of goods, deficiency is relevant in case of services. Accordingly, it is defined to mean any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service.

Example: The management of Excel Public School owned a swimming pool and offered swimming facilities to the public on payment of certain fee. The management had engaged an experienced coach for coaching people how to swim. One day, a boy of 14 years got drowned and died while learning swimming. The father of the deceased boy claimed for relief. The school management denied responsibility by stating that it had requisitioned services of a qualified and experienced coach. The coach also denied responsibility claiming that he had taken all possible precautions, taken the boy out of water and removed water from his stomach.

The father of the deceased boy succeeded in his claim for relief. The school and the coach were deficient in rendering service to the deceased. The admission to the swimming pool was on payment of certain fees, therefore the complainant had hired the services of the school for consideration. The father of the deceased is a consumer and the negligence of the coach amounts to deficiency in service.

District Forum. 'District Forum' means a consumer Dispute Redressal Forum established under clause (a) of Sec.9. This section provides that for the purposes of the Act a Consumer Disputes Redressal Forum to be known as the 'District Forum' established by the State Government in each district of the State by notification. The State Government may, if it deems fit, establish more than one District Forum in a district.

Goods. 'Goods' under this Act shall have the same meaning as assigned to them under the Sale of Goods Act, 1930. Accordingly, 'Goods' means every kind of movable property other than actionable claims and money; and includes stock 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 [Sec.2(7) of the Sale of Goods Act, 1930].

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Manufacturer. The expression 'Manufacturer' for the purpose of this Act, means any of the following persons: (i) A person who makes or manufactures any goods or part thereof. (ii) A person who does not make or manufacture any goods but assembles parts thereof made or manufactured by others. But, where a manufacturer dispatches any goods or parts thereof to any branch office maintained by him, such branch office shall not be deemed to be manufacturer even though the parts so dispatched to it are assembled at such branch office and are sold or distributed from such branch office. (iii) A person who puts or causes to be put his own mark on any goods made or manufactured by any other manufacturer.

National Commission: 'National Commission' means the National Consumer Disputes Redressal Commission established under clause (c) of Sec.9. This section provides that there shall be established for the purposes of this Act a National Consumer Disputes Redressal Commission established by the Central Government by notification. The Government vide powers conferred upon it under the said clause established a National Commission in 1987.

Example: A dealer in precious stones and gems had sent four parcels of gems by registered post duly insured to a consignee in U.S.A., but the parcels did not reach the destination. The investigation revealed that the parcels were either lost in transit or were stolen. The postal authorities admitted their liability and made payment of postal charges in respect of each parcel. The insured agreed to settle the claim. However, he insisted that the payment of the insured amount should be made in U.S. dollars. The insurer denied their liability to pay in dollars to the dealer. The dealer made a complaint to the National Commission.

The dealer would not succeed as he continues to be the owner of the goods and the title in the goods has not passed to the consignee. It is the dealer who has the insurable interest in the goods.

Service

'Service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.

Example: Maina Devi's husband took a life insurance policy for ₹ 50,000. Before the second premium fell due, he died due to sudden illness. The claim made by her was not entertained for as long as 14 years. It was only when she got her miseries published in newspapers and certain MPs took up the matter in Parliament that she was sent a cheque for ₹ 50,39.

She made a complaint to the National Commission for deficiency of service by Life Insurance Corporation of India. The National Commission held that the Corporation had been highly negligent in the performance of its services. Maina Devi, the complainant, had suffered hardship and loss on account of deficiency in service. She was held entitled to interest @12% p.a. from the date of expiry of 3 months from the date of death of the assured till the amount was paid to her. The Commission also awarded her compensation of ₹ 15,000 for mental torture and harassment.

Restrictive Trade Practice

This definition was introduced in the Act vide Amendment Act, 1993. It has now been amended by the Amendment Act, 2002. It provides that a "restrictive trade practice" means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow

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of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include:

1. delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price.
2. any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent to buying, hiring or availing of other goods or services;

Task S booked a motor vehicle through one of the dealers. He was informed subsequently that the procedure for purchasing the motor vehicle had changed and was called upon to make further payment to continue the booking before delivery. On being aggrieved, S filed a complaint with the State Commission. Would he succeed?

[*Hint:* S would not succeed, as he is not a consumer. The sale transaction has not taken place so far. Therefore there is no question of any defect in the goods. In case it is alleged that the dealer is indulging in any unfair trade practice and that S has suffered some loss or damage as a result thereof, then S has to prove all these before his petition can be entertained.]

16.2 Rights of Consumers

For the first time in the history of consumer legislation in India, the Consumer Protection Act, 1986 extended a statutory recognition to the rights of consumers. Sec.6 of the Act recognizes the following six rights of consumers:

1. ***Right to safety,*** i.e., the right to be protected against the marketing of goods and services which are hazardous to life and property.
2. ***Right to be informed,*** i.e., the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices.
3. ***Right to choose:*** It means right to be assured, wherever possible, access to a variety of goods and services at competitive prices. In case of monopolies, say, railways, telephones, etc., it means right to be assured of satisfactory quality and service at a fair price.
4. ***Right to be heard,*** i.e., the consumers' interests will receive due consideration at appropriate forums. It also includes right to be represented in various forums formed to consider the consumers' welfare.
5. ***Right to seek redressal:*** It means the right to seek redressal against unfair practices or restrictive trade practices or unscrupulous exploitation of consumers. It also includes right to fair settlement of the genuine grievances of the consumers.
6. ***Right to consumer education:*** It means the right to acquire the knowledge and skill to be an informed consumer.

Notes

Note Mohan submitted certain documents before the Sub-Registrar for registration claiming these as will. These documents were found to be a deed of conveyance and also improperly stamped. The Sub-Registrar impounded the documents and forwarded these to the Collector of Stamps. The Collector of Stamps asked Mohan to appear before him. He neither appeared before the Collector of Stamps nor submitted any other documents. Mohan instead filed a complaint before the Consumer Forum that he has been harassed for 3 years and that there has been deficiency in service on the part of the Sub-Registrar and the Collector of Stamps.

Mohan is not a consumer. The Sub-Registrar and Collector of Stamps only perform their statutory duties to raise and collect the state revenue, which is a part of the sovereign function of the State. The Registration Act and the Stamp Act are meant primarily to augment the state revenue. A person who presents documents for registration and pays the stamp duty on it or the registration fee does not become a consumer. Also the officers under these two Acts are not rendering any service to Mohan. Therefore, Mohan is not a consumer and has no remedy under the Consumer Protection Act.

16.3 Nature and Scope of Remedies available to Consumers

To provide simple, speedy and inexpensive redressal of consumer grievances, the Act envisages three-tier quasi-judicial machinery at the District, State and National levels. At the District level there are to be District Fora as the redressal fora. The State Government may, if it deems fit, establish more than one District Forum in a District. At the State level, there are to be similar redressal commissions to be known as State Commissions and at the National level, there is a National Consumer Disputes Redressal Commission to be known as National Commission.

16.3.1 Who can file a Complaint? (Sec.12)

Any of the following persons may file a complaint under the Act:

1. The consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service provided or agreed to be provided.

   In case of death of a consumer, his legal heir or representative can file a complaint.

2. Any recognised consumers association namely, any voluntary consumer association registered under the Companies Act, 1956 or any other law for the time being in force. It is not necessary that the consumer is a member of such an association.

3. One or more consumers, where there are numerous consumers having the same interest, with the permission of the District Forum, on behalf of, or for the benefit of, all consumers so interested.

4. The Central or the State Government.

The Amendment Act, 2002 has amended Sec.12. It provides as follows:

1. Every complaint shall be accompanied with such amount of fee as prescribed.

2. On receipt of a complaint, the District Forum may, by order, allow the complaint to be proceeded with or rejected.

   However, a complaint shall not be rejected unless an opportunity of being heard has been given to the complainant.

3. Where a complaint is allowed to be proceeded with, the District Forum may proceed with the complaint in the manner as provided under the Act.

Notes

16.3.2 Where to file a Complaint?

1. If the value of the goods or services and the compensation, if any, claimed does not exceed rupees twenty lakhs, then the complaint can be filed in the District Forum within the local limits of whose jurisdiction the opposite party actually resides or carries on business or has a branch office or personally works for gain or where the cause of action, wholly or in part, arises (Sec.11).
2. If the value of the goods or services and compensation, if any, claimed exceeds rupees twenty lakhs but does not exceed rupees one crore, the complaint can be filed before the State Commission (Sec.17).

   Where a joint petition is filed on behalf of a large number of victims, it is the total amount of compensation claimed in the petition (and not the individual claims) that will determine the question of jurisdiction. In case the total compensation claimed exceeds, presently, ₹20 lakhs but does not exceed Rupees one crore, the matter can be heard by the State Commission [Public Health Engineering Department v Uphokta Sanrakshan Samiti (1992)].

   The State Commission shall also have the jurisdiction to entertain appeals against the orders of any District Forum within the State. (Sec.17).
3. If the value of goods or services and the compensation, if any, claimed exceeds Rupees one crore, complaint can be filed before the National Commission. The National Commission shall also have the jurisdiction to entertain appeals against the orders of any State Commission [Sec.21].

16.3.3 How to file a Complaint?

There is no fee for filing a complaint before any of the aforesaid bodies. The complainant or his authorised agent can present the complaint in person. The complaint can also be sent by post to the appropriate Forum/Commission. The complaint should be addressed to the President of the Forum/Commission. A complaint should contain the following information: (a) the name, description and address of the complainant; (b) the name, description and address of the opposite party or parties, as the case may be, as far as they can be ascertained; (c) the facts relating to complaint and when and where it arose; (d) documents, if any, in support of the allegations contained in the complaint; (e) the relief which the complaint is seeking.

16.3.4 Procedure on Admission of Complaint (Sec.13)

1. ***Procedure in respect of goods where the defect alleged requires no testing or analysis:***
   (i) Refer a copy of the admitted complaint within 21 days from the date of its admission to the opposite party mentioned in the complaint directing him to give his version of the case within a period of 30 days or such extended period not exceeding 15 days, as may be granted by the District Forum.
   (ii) Where the opposite party, on admission of a complaint referred to him under (a) above, denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Forum, the District Forum shall proceed to settle the consumer disputes in the manner specified in clauses (c) to (g) hereunder.
2. ***Procedure in respect of goods where the defect alleged requires analysis or testing:***
   (i) Where a complainant alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, the District Forum shall obtain a sample of the goods from the complainant, seal it and authenticate it in the manner

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prescribed. It shall then refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory make an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect alleged in the complaint or from any other defect and to report its findings thereof to the District Forum within a period of 45 days of the receipt of the reference or within such extended period as may be granted by the District Forum [Clause (c)].

(ii) Before any sample of the goods is referred to any appropriate laboratory under clause (c), the District Forum may require the complainant to deposit to the credit of the Forum such fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question [Clause (d)].

(iii) The District Forum shall remit the amount deposited to its credit under clause (d) to the appropriate laboratory to enable it to carry out the analysis or test as aforesaid. On receipt of the report from the appropriate laboratory, the District Forum shall forward a copy of the report along with such remarks as the District Forum may feel appropriate to the opposite party [Clause (e)].

(iv) If any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the method of analysis or test adopted by the appropriate laboratory, the District Forum shall require the opposite party or the complainant to submit in writing his objections in regard to the report made by the appropriate laboratory [Clause (f)].

(v) The District Forum shall thereafter give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto under clause (f) and issue an appropriate order under Sec.14 [Clause (g)].

16.3.5 Power of the District Forum [Sec.13(4)]

District Forum shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely: (i) the summoning and enforcing the attendance of any defendant or witness and examining the witness on oath; (ii) the discovery and production of any document or other material object producible as evidence; (iii) the reception of evidence on affidavits; (iv) the requisitioning of the concerned analysis or test from the appropriate laboratory or from any other relevant source; (v) issuing of any commission (i.e., warrant conferring authority) for the examination of any witness; and (vi) any other matter which may be prescribed.

16.3.6 Reliefs available to Consumers (Sec.14)

If, after the proceeding conducted under Sec.13, the District Forum is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to do one or more of the following things, namely: (a) to remove the defect pointed out by the appropriate laboratory from the goods in question. (b) to replace the goods with new goods of similar description which shall be free from defects. (c) to return to the complainant the price, or as the case may be, the charges paid by the complainant. (d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party. (e) to remove the defects in goods or deficiencies in the services in question. (f) to discontinue the unfair trade practice or the restricted trade practice or not to repeat them. (g) not to offer the hazardous goods for sale. (h) to withdraw

Notes

the hazardous goods from being offered for sale; (ha) to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature; (hb) to pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently; (hc) to issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement. (i) to provide for adequate costs to parties.

In (a) above, the District Forum shall have the power to grant punitive damages, as it deems fit.

16.3.7 Time-frame for Decisions of Consumer Courts

The complaint should be decided by the Redressal Forum, as far as possible, within a period of 3 months from the date of the notice received by the opposite party where complaint does not require analysis or testing of the commodities and within 5 months if it requires analysis or testing of commodities.

16.3.8 Vacancies or Defects in appointment not to invalidate order (Sec.29A)

No Act or proceeding of the District Forum, the State Commission or the National Commission shall be invalid by reason only of the existence of any vacancy amongst its members or any defect in the constitution thereof.

Enforcement of orders of the District Forum, the State Commission or the National Commission. The Amendment Act, 2002 has substituted Sec.25 by a new section. It provides as follows:

1. Where an interim order made under this Act is not complied with, the District Forum or the State Commission or the National Commission, as the case may be, may order the property of the person, not complying with such order, to be attached.
2. No attachment made under Sub-sec.(1) shall remain in force for more than three months at the end of which, if the non-compliance continues, the property attached may be sold and out of the proceeds thereof, the District Forum or the State Commission or the National Commission may award such damages as it thinks fit to the complainant and shall pay the balance, if any, to the party entitled thereto.
3. Where any amount is due from any person under an order made by a District Forum, State Commission or the National Commission, as the case may be, the person entitled to the amount may make an application to the District Forum, the State Commission or the National Commission, as the case may be, and such District Forum or the State Commission or the National Commission may issue a certificate for the said amount to the Collector of the district (by whatever name called) and the Collector shall proceed to recover the amount in the same manner as arrears of land revenue.


Task

Suggest the time frame for decisions of consumer court?

Notes

16.4 Appeal

16.4.1 Appeal to State Commission

Any person aggrieved by an order made by the District Forum may prefer and appeal against such order to the State Commission within a period of 30 days from the date of the order. However, the State Commission may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period.

A proviso to S.15 provides that no appeal by a person, who is required to pay any amount in terms of an order of the District Forum, shall be entertained by the State Commission unless the appellant has deposited 50 per cent of that amount or ₹ 25000, whichever is less.

Section 17B provides that the State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the state government may notify from time to time. This is known as constitution of Circuit Benches.

Procedure Applicable to State Commissions

The provisions of Ss.12, 13 and 14 (Discussed under procedure applicable to District Forums) and the rules made there under for the disposal of complaints by the District Forum shall, with such modifications as may be necessary, be applicable to the disposal of disputes by the State Commission [s.18].

16.4.2 Appeal to National Commission

Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of 30 days from the date of the order [s.19].

No appeal by a person who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission, unless the appellant has deposited 50 per cent of the amount or ₹ 55000 whichever is less.

Section 19A provides that an appeal filed before the state commission or the National Commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of 90 days from the date of its admission.

16.4.3 Power and Procedure Applicable to the National Commission [S.22]

Section 22 has been substituted by a new section by the Amendment Act 2002. It provides as follows:

1. The provisions of section 12, 13 and 14 and the rules made there under for the disposal of complaints by the District Forum shall be applicable to the disposal of disputes by the National Commission.
2. The National Commission shall have the power to review any order made by it, when there is an error apparent on the face of the record.

   Power to set aside ex parte orders: Section 22A provides that where an order is passed by the National Commission ex parte against the opposite party or a complainant, as the ase may be, the aggrieved party may apply to the Commission to set aside the said order in the interest of justice.

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Transfer of cases: Section 22B provides that on the application of the complainant or of its own motion, the National Commission may, at any stage of the proceeding, in the interest of justice, transfer any complaint pending before the District Forum of one state to a District Forum of another state or before one State Commission to another State Commission.

Circuit Benches: Section 22C provides that the National Commission shall ordinarily function at New Delhi and perform its functions at such other place as the Central Government may notify from time to time.

Vacancy in the office of the President: Section 22D provides that when the office of the President of a District Forum, State Commission, or of the National Commission, as the case may be, is vacant or a person occupying such office is, by reason of absence or otherwise, unable to perform the duties of his office, these shall be performed by the senior-most member of the District Forum, the State Commission, or of the National Commission, as the case may be.

16.4.4 Do Consumer Forums have the Right to Grant Interim Stay (Temporary Injunction)

The Supreme Court in Morgan Stanley Mutual Fund v Karick Das and Dr Arvind Gupta v SEBI and Others (II 1994 CPJ 7) held that consumer forums do not have any power to pass any interim order. It ruled that under s.14 relief by way of ad-interim stay was not at all contemplated. Therefore, the forums granting any stay by way of interim order would be acting beyond their jurisdiction under the Act. The Amendment Act, 2002 however, has provided for issue of interim orders by redressal agencies.

16.4.5 Appeal to the Supreme Court against the Orders of National Commission

Any person, aggrieved by an order made by the National Commission, may prefer an appeal against such order to the Supreme Court, within a period of 30 days from the date of the order. However, Supreme Court may entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period [s.23].

No appeal by a person who is required to pay any amount in terms of an order of the National Commission shall be entertained by the Supreme Court unless that person has deposited 50 per cent of that amount or ₹ 55000 whichever is less.

16.4.6 Finality of Orders (S.24)

Every order of a District Forum, the State Commission or the National Commission shall, if no appeal has been preferred against such order under provisions of the Act, be final.

16.4.7 Limitation Period (S.24A)

The District Forum, the State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

However, a complaint may be entertained after the specified period of two years if the complainant satisfies the District Forum, the State Commission or the National Commission, as the case may be, that he had sufficient cause for not filing the complaint within such period. But, no such complaint shall be entertained unless the District Forum, the State Commission or the National Commission, as the case may be, records its reasons for condoning such delay.

Notes

Case Study

Governmental responsibility for food in Canada is divided among the federal, 10 provincial, three territorial, and thousands of municipal governments. Some 77 pieces of legislation govern food inspection among three levels of government. Federal responsibility centres on export and inter-provincial trade: protecting and expanding export markets for Canadian food products, and facilitating interprovincial trade. In addition, the federal government sets food safety, quality and grading standards for products sold inter-provincially and internationally and administers regulations aimed at preventing the production or sale in Canada of dangerous, adulterated or misbranded products.

Provinces and municipalities are responsible for:

The intraprovincial aspects of the food industry, including local food processing, the food service industry, and the food retail industry.

They decide whether and how to inspect local operations, including restaurants and grocery stores, as well as dairies and meat plants whose products are sold within the province. (Moore and Skogstad, p. 130) The federal government of Canada faced a number of food security problems in the early 1990s, which facilitated adoption of innovative reform measures:

1. Canada's reputation for high quality food had been damaged by the "tainted tuna" scandal.
2. Resources for additional inspection of fish products were not available; resources were not only scarce but shrinking.
3. The Government wanted to reform its public service along the lines achieved in the United Kingdom and New Zealand, where separate agencies were spun off from government.
4. Developments in international trade and potential developments in interprovincial trade:
   (a) Industry and governments favoured harmonized standards and streamlined inspection to ensure the competitiveness of the Canadian food industry domestically & internationally.
   (b) Canadian producers/processors were vulnerable to trade challenges in a fragmented system.
   (c) Gaps resulting from non-inspection or non-rigorous inspection were perceived by processors as a weak link, despite the small percentage of overall production represented and assurances outlined in the Auditor General of Canada's 1994 Report.
   (d) Closer integration of the US and Canadian markets under free trade agreements made the industry anxious to reduce the costs and inefficiencies resulting from differing provincial standards e.g. fluid milk.
5. The "national treatment" principle in the North American Free Trade Agreement could be interpreted to mean that imports must meet the provincial standard of the province they enter rather than the standard required for inter-provincial or

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international trade. This could drag down Canadian food standards to the lowest common denominator.

(a) Canadian exporters were concerned about being denied access to external markets on the grounds that Canadian food safety standards and inspection systems were not equivalent to those of the markets into which they were shipping.

(b) The 1994 SPS Agreement required that countries use their food safety and animal, plant and health regulations only to the extent necessary to protect human, animal life or health, not for trade protection purposes.

6. Emergence of alternatives to high-cost prescriptive regulation: New scientific and technological tools furnished the Government with opportunities to shift additional costs and a significant degree of responsibility for food safety to the food industry itself. Risk assessment methods allowed the allocation of food inspection resources on a risk basis. One such risk-based tool, the Hazard Analysis Critical Control Point (HACCP) system, developed for the US space program, was deemed more effective than existing systems in ensuring food safety. Canada was the first government to adopt this system, for its fish inspection program. It was so well accepted internationally that Canadian meat packing plants were subsequently required to conform to US regulations requiring large American meat packing plants to implement a HACCP plan by January 1998.

7. National unity was threatened, and solutions suggested in the winning Liberal platforms in the 1993 and 1997 elections were renewal of the federation, including better coordination of services and reduction in overlap and duplication among governments.

The Government of Canada consolidated all of its food inspection and quarantine services from Health Canada, Fisheries and Oceans, and Agriculture and Agri-Food Canada into one self-standing Agency effective April 1, 1997. The Agency reports not to a deputy minister but directly to the Minister of Agriculture and Agri-Food. The Agency has separate employer status, and so can hire and fire its own employees, rather than working through the Public Service Commission. It also has a number of financial flexibilities not available to government departments, most notably the capacity to retain revenues.

Protecting the public interest is a major concern in creating alternate Service Delivery Agencies (ASDs) in Canada. Employing the Auditor General of Canada's definition of the public interest when assessing ASDs, the CFIA addressed whether there was an appropriate focus on public objectives, maintenance of public service values and adequate control over public funds and assets. On all counts the CFIA's self-assessment concluded it was serving the public interest.

The Auditor General of Canada was appointed as an external auditor under the CFIA Act, with duties to audit the CFIA's financial statements and assess the fairness and reliability of the performance information provided in the Agency's Annual Report to Parliament. The Auditor General also has authority to conduct periodic value-for-money audits of the Agency.

Clarification of food-related roles and responsibilities of federal government departments has led to:

(a) A more integrated and comprehensive approach (gate-to-plate) to trichinosis in swine, tuberculosis in cattle and zoonotic diseases such as salmonella enteritidis in poultry.

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(b) Improved capacity to respond to outbreaks of food-borne illness and threats to the food system presented by medicated feeds and antibiotic residues.

(c) Separation of health and safety standard setting from inspection, permitting new flexibilities for inspection.

(d) Separation of health risk analysis from risk management, thereby fulfilling a World Health Organization principle.

(e) Reduced criticism of conflict of interest because the same department was responsible for promoting and regulating an industry (fisheries).

8. A more integrated and comprehensive approach (gate-to-plate) to trichinosis in swine, tuberculosis in cattle and zoonotic diseases such as salmonella enteritidis in poultry.

9. Improved capacity to respond to outbreaks of food-borne illness and threats to the food system presented by medicated feeds and antibiotic residues.

10. Separation of health and safety standard setting from inspection, permitting new flexibilities for inspection.

11. Separation of health risk analysis from risk management, thereby fulfilling a World Health Organization principle.

12. Reduced criticism of conflict of interest because the same department was responsible for promoting and regulating an industry (fisheries).

Question

Analyse the kind of agency it is.

(*Hint:* It is a self-standing agency with a separate employer status and more financial flexibilities.)

16.5 Summary

- The earlier principle of "Caveat Emptor" or "let the buyer beware" which was prevalent has given way to the principle of "Consumer is King".
- The origins of this principle lie in the fact that in today's mass production economy where there is little contact between the producer and consumer, often sellers make exaggerated claims and advertisements, which they do not intend to fulfill.
- This leaves the consumer in a difficult position with very few avenues for redressal.
- The onset on intense competition also made producers aware of the benefits of customer satisfaction and hence by and large, the principle of "consumer is king" is now accepted.
- The need to recognize and enforce the rights of consumers is being understood and several laws have been made for this purpose. In India, we have the Indian Contract Act, the Sale of Goods Act, the Dangerous Drugs Act, the Agricultural Produce (Grading and Marketing) Act, the Indian Standards Institution (Certification Marks) Act, the Prevention of Food Adulteration Act, the Standards of Weights and Measures Act, the Trade and Merchandise Marks Act, etc which to some extent protect consumer interests.
- However, these laws required the consumer to initiate action by way of a civil suit, which involved lengthy legal process proving, to be too expensive and time consuming for lay consumers.

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- Therefore, the need for a simpler and quicker access to redressal to consumer grievances was felt and accordingly, it lead to the legislation of the Consumer Protection Act, 1986.
- 'Service' means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing.
- Goods' means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land.

16.6 Keywords

Complaint: Complaint many allegation in writing by a complainant with a view to obtaining any relief under the Act.

Consumer Dispute: Dispute where the person against whom a complaint has been made, denies or disputes the allegation contained in the complaint.

Consumer: Any person who buys any goods for consideration which has been paid or promised or partly paid and partly promised.

Defect: It is defined to mean any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained.

Service: It means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing.

16.7 Self Assessment

Choose the appropriate answer:

1. Consumer Protection Act, applies to
   (a) All products and services
   (b) Only physical products
   (c) Only services
   (d) Only certain products and service
2. Any of the following made a complaint EXCEPT
   (a) A consumer
   (b) The Central Government
   (c) In case of death of consumer, his legal heir or representative
   (d) None
3. Consumer Protection Act, 1986 was amended in
   (a) 1991, 1993 and 2001
   (b) 1991, 1993 and 2002
   (c) 1992, 1993 and 2002
   (d) 1992, 1993 and 2001
4. Right to acquire the knowledge and skill to be an informed consumer is a:
   (a) Right to be heard
   (b) Right to be informed

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(c) Right to consumer education

(d) Right to safety

5. The expression 'Manufacturer' for the purpose of this Act, means any of the following, EXCEPT.

   (a) A Hindu Undivided Family

   (b) A person who makes are manufactures any goods

   (c) A person who does not make or manufacture any good but assembles part thereof made.

   (d) All of the above

6. The complaint can be filled in the 'District Forum' if

   (a) The value of goods or services and compensation, if any, claimed exceeds rupees twenty lakhs.

   (b) The value of goods or services and compensation, if any, claimed exceeds rupees twenty lakhs but not exceed rupees 1 crore.

   (c) Both (a) and (b)

   (d) Only (a)

7. Which amendment of Consumer Protection Act, permitted representative complaints.

   (a) Consumer Protection Act, 1991

   (b) Consumer Protection Act, 1992

   (c) Consumer Protection Act, 1993

   (d) Consumer Protection Act, 2002

8. Transfer of cases comes under which section.

   (a) Sec.22 B

   (b) Sec.22 C

   (c) Sec.22 D

   (d) Sec.22 A

9. Sec.28 A inserted in which amendment of Consumer Protection Act,

   (a) Amendment Act, 1991

   (b) Amendment Act, 1992

   (c) Amendment Act, 1993

   (d) Amendment Act, 2002

10. AGMARK stands for

    (a) Agricultural Process and Grading and Marketing Act,

    (b) Agricultural Products and Grading and Marketing Act,

    (c) Agricultural Products and Graduate and Marketing Act,

    (d) None

Notes

16.8 Review Questions

1. Describe the main features of the Consumer Protection Act, 1986.
2. What are the objects which the Consumer Protection Act, 1986 seeks to achieve?
3. Can the following be regarded as consumers:
   (a) A patient of a government hospital.
   (b) A person who registers himself for a telephone connection.
   (c) A person sending a telegram.
4. Examine the rights of a consumer enshrined under the Consumer Protection Act, 1986.
5. Explain the procedure District Forum follows on receipt of a complaint from a consumer.
6. What sort of complaint may be lodged under the Act?
7. Where and how can a complaint be made? State the jurisdiction of the various redressal agencies in this regard.
8. Discuss the Appeal to State Commission
9. In which way the Consumer Protection Act can help the consumers in the redressal of their grievances?
10. Can the following be regarded as consumers? (a) A patient of a government hospital. (b) A person who registers himself for a telephone connection. (c) A person sending a telegram.

Answer: Self Assessment

1. (a)	2. (d)	3. (b)	4. (c)
5. (a)	6. (a)	7. (c)	8. (a)
9. (d)	10. (b)		

16.9 Further Readings

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LOVELY PROFESSIONAL UNIVERSITY
Jalandhar-Delhi G.T. Road (NH-1)
Phagwara, Punjab (India)-144411
For Enquiry: +91-1824-300360
Fax.: +91-1824-506111
Email: odl@lpu.co.in