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Indira Gandhi National Open University
School of Management Studies

BCOC-133
BUSINESS LAW

Volume 1

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Block

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BLOCK 1 GENERAL LAW OF CONTRACT-I

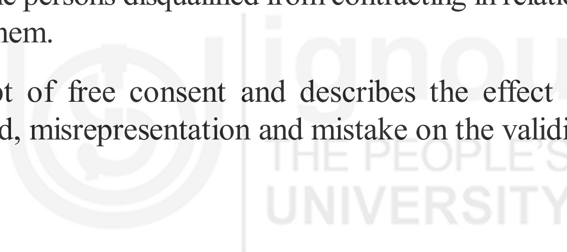
There are several branches of law such as international law, constitutional law, criminal law, civil law, etc. Every law regulates a particular field of activity. Business Law also known as mercantile law is a part of civil law which deals with the rights and obligations arising out of business transactions. It regulates the trade and commerce in a country. The law of contract (the Indian Contract Act, 1872) is the most important part of mercantile law. It deals with the general principles of law governing all contracts and covers the special provisions relating to contracts like bailment, pledge, indemnity, guarantee and agency.

The general law of cantract relates to the essentials of a valid contract, the rules for performance and discharge of a contract, and the remedies available to the aggrieved party in case of breach. This block mainly covers the essentials of a valid contract like offer and acceptance, capacity of parties, and free consent.

Unit 1 explains the meaning ot contract and its classification. It also gives a resume of the essentials of a valid contract.

Unit 2 describes the rules relating to offer and acceptance and also their communication and revocation.

Unit 3 deals with the capacity of parties and discusses the position of a minor, a person of unsound mind and the persons disqualified from contracting in relation to contracts entered into by them.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Unit 4 deals with the concept of free consent and describes the effect of coercion, undue influence, fraud, misrepresentation and mistake on the validity of contract.

UNIT 1 ESSENTIALS OF A CONTRACT

Structure

1.0 Objectives

1.1. Introduction

1.2 What is Law?

1.3 Meaning and Sources of Business Law

1.4 The Law of Contract

1.5 What is a Contract?

- 1.5.1 Agreement
- 1.5.2 Legal Obligation
- 1.5.3 Difference between an Agreement and a Contract

1.6 Classification of Contracts

- 1.6.1 On the Basis of Creation
- 1.6.2 On the Basis of Execution
- 1.6.3 On the Basis of Enforceability

1.7 Essentials of a Valid Contract

1.8 Let Us Sum Up

1.9 Key Words

1.10 Answers to Check Your Progress

1.11 Terminal Questions/Exercises

1.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the purpose of law;
- describe the sources of business law;
- explain the meaning of contract;
- distinguish between a contract and an agreement;
- classify the contracts;
- distinguish between void, voidable and illegal contracts; and
- describe the essentials of a valid contract.

1.1 INTRODUCTION

The law of contract is the most important branch of Business Law. Without such a law it would be difficult, if not impossible, to carry on any trade or business in a smooth manner. The law of contract is applicable not only to business but also to all day-to-day personal dealings. In fact, each one of us enter into a number of contracts from sunrise to sunset. When a person buys

a newspaper or rides a bus or purchases goods or gives his radio for repairs or borrows a book from library, he is actually entering into a contract. All these transactions are subject to the provisions of the law of contract. So one should know the law relating to contacts, not only for business but for all personal dealings. In this introductory unit you will learn, first of all, why we need law and what its various branches are. Then you will learn about the meaning of business law, its sources, and the basic aspects of the law of contract viz., the meaning of contract, its classification and the essentials of a valid contract.

1.2 WHAT IS LAW?

Before learning the meaning of the term 'Law' you must know as to why we need law. No civilised society can exist without law. It is required for the preservation of peace and orderliness in every society. Without law, no person will care for others and their dealings may not materialise. With the growth of society and the concept of welfare state, it became necessary to regulate the conduct of people and protect their property and contractual rights. Hence, each country enacted laws suited to its various needs and the value system it cherished.

It is imperative that we should know the law to which we are subject, because ignorance of law is no excuse. For example, if a person is caught travelling in a train without ticket, he cannot plead that he was not aware of the rule regarding the purchase of ticket and therefore he may be excused. Hence, in our own interest, we should be conversant with the laws that are applicable to us.

Law means a 'set of rules'. Broadly speaking, it may be defined as the rules of conduct recognised and enforced by the state to control and regulate people's behaviour with a view to securing justice, peaceful living and social security. Some of the important definitions of the term 'law' are as follows:

> *"Law is a rule of civil conduct, prescribed by the supreme power of state, commanding what is right and prohibiting what is wrong." Blackstone.*
>
> *"Law is the body of principles recognised and applied by the state in the administration of justice." – Salmond.*

From the definitions given above, you will notice that law is a set of rules and principles relating to human actions with a view to regulate the actions of human beings in respect of one another and in relation to the society. You know the society is not static, its value system keeps on changing. Hence, law also keeps changing according to the changing requirements of the society.

There are several branches of law, such as international law, constitutional law, criminal law, civil law, etc. Every law regulates and controls a particular field of activity. Bunsiness law also known as mercantile law or commercial law is not a separate branch of law. **It is a part of civil law which deals with the rights and obligations of mercantile persons arising out of commercial transactions in respect of mercantile property.**

1.3 MEANING AND SOURCES OF BUSINESS LAW

You have learnt that business law is a part of civil law and it governs and regulates the trade and commerce in a country. In other words, the business law

groups together laws that are considered important for men in business and includes laws relating to various contracts, partnerships, companies, negotiable instruments, insurance, carriage of goods, arbitration, etc.

Indian business law is primarily an adaptation of the English law. The different Indian Acts follow, to a considerable extent, the English mercantile law with some reservations and modifications necessitated by the peculiar conditions prevailing in India. The main sources of business law in India are as follows:

1) **English Mercantile Law:** Our laws are based primarily on the English laws which developed through customs and usages of merchants or traders in England, these customs and usages governed these merchants in their dealings with each other. This law is also known as 'Common Law'. As a matter of fact, it is an unwritten law based on customs, usages and precedents. The most important part of mercantile law, namely, the Law of Contracts, is still a part of Common Law in England.

2) **Indian Statute Law:** The Acts passed by the Indian Legislature are the main source of 1ndian business law. The important Acts passed by the Indian Legislature are: The Indian Contract Act 1872; The Negotiable Instruments Act 1881; The Sale of Goods Act 1930; The Indian Partnership Act 1932; The Companies Act 2013; Consumer Protection Act 1986; The Securities and Exchange Board of India Act, 1992; The Information Technology Act, 2000, and so on.

3) **Judicial Decisions (or case law):** The past judicial decisions of courts are another important source of law. They are generally followed by the courts while deciding similar cases before them. The past decisions have persuasive and guiding value. Wherever the law is silent on a point, the judge has to decide the case according to the principle of equity, justice and good conscience. The decisions of English courts are also frequently referred to as precedents in deciding various cases and for interpreting the Indian Statutes.

4) **Customs and Usages:** The customs and usages of particular trade are yet another important source of Indian mercantile law. They play an important role in regulating the dealings between the merchants of that trade. But it is necessary that such customs or usages must be widely known, reasonable, constant and must not be inconsistent with the law. The Indian Contract Act recognises this fact by providing that "nothing contained therein shall affect any usage or custom of trade." The Negotiable Instruments Act also makes a similar provision. It says that "nothing contained therein shall affect any local usage relating to instruments in an oriental language."

1.4 THE LAW OF CONTRACT

The law of contract is the most important part of business law in India. It determines the circumstances in which the promises made by the parties to a contract shall be binding on them and provides for the remedies available against a person who fails to perform his promise. The law of contract is contained in the Indian Contract Act, 1872, which deals with the general principles of law governing all contracts and covers the special provisions relating to contracts like bailment, pledge, indemnity, guarantee and agency.

Before 1930, this Act also contained the special provisions relating to contracts of sale of goods and partnership. In 1930, however, these provisions were repealed and separate Acts called the 'Sale of Goods Act' and the 'Indian Partnership Act' were passed governing the contracts of sale of goods and partnership respectively. Similarly, there are separate Acts for contracts relating to negotiable instruments, insurance, carriage of goods, etc.

Let us now study the exact nature of a contract and the other important aspects relating to it.

1.5 WHAT IS A CONTRACT

Broadly speaking, a contract is an agreement made between two or more persons to do or to abstain from doing a particular act. A contract invariably creates a legal obligation between the parties by which certain rights are given to one party and a corresponding duty is imposed on the other party. A contract has been defined by different authorities in various ways. Some of the important definitions are as follows:

A contract is an agreement, creating and defining the obligation between parties. – Salmond

A contract is an agreement enforceable at law made between two or more persons by which rights are acquired by one or more to acts or forbearance on the part of others. – Sir William Anson

Every agreement and promise enforceable at law is a contract.

– Sir Fredrick Pollock

The definition as given in the Contract Act is based on Pollock's definition. Section 2(h) of the Act states that an agreement enforceable by law is a contract. On analysing this definition of contract, you will notice that a contract essentially consists of two elements: (i) an agreement, and (ii) its enforceability by law.

Let us discuss these two elements in detail.

1.5.1 Agreement

Section 2(e) of the Contract Act defines agreement as *every promise and every set of promises forming the consideration for each other.* In this context a promise refers to a proposal (offer) which has been accepted. For example, Ramesh offers to sell his scooter for Rs. 20,000 to Shyam. Shyam accepts this offer. It becomes a promise and treated as an agreement between Ramesh and Shyam. In other words, an agreement consists of an offer by one party and its acceptance by the other. Thus,

Agreement = Offer + Acceptance

From the above analysis it is clear that there must be at least two parties to an agreement, one making an offer and the other accepting it. No person can enter into agreement with himself. There is another important aspect relating to an agreement i.e., the parties to an agreement must have an identity of minds

in respect of the subject matter. They must agree on the same thing in the same sense. This is also called consensus-ad-idem. Suppose A has two houses, one situated in South Delhi and the other in North Delhi. He offers to sell his North Delhi house to B while B is under the impression that he is buying the South Delhi house. Here, there is no identity of minds. Both the parties are thinking about different houses. Hence there is no agreement.

1.5.2 Legal Obligation

In order that an agreement may be regarded as a contract, it must give rise to a legal obligation i.e., it must be enforceable by law. Any obligation (duty) which is not enforceable by law is not regarded as a contract. Social, moral or religious agreements do not create any legal obligation. For example, an agreement to take lunch together or to go to a picnic is not a contract because it does not create a duty enforceable by law. Such agreements are purely of a social nature where there is no intention to create legal relationship. Hence, they do not result in contracts. In case of business agreements, however, the usual presumption is that the parties intend to create a legal relationship. For example, an agreement to sell a scooter for Rs. 20,000 is a contract because it gives rise to an obligation enforceable by law. In this agreement if there is default by either party, an action for breach of contract can be enforced through a court of law provided all the essentials of a valid contract are present in the agreement.

You must also note that every obligation which is enforceable by law is not automatically regarded as a contract. The obligations which do not arise out of agreements but from sources such as wrongful acts, judicial decisions or decree of a court, husband and wife relationship are not regarded as contracts. Thus, the **law of contract is concerned with only those obligations which arise out of agreement**. Salmond has rightly said about the law of contract that ".............It is the law of those agreements which create obligations, and those obligations which have their source in agreements."

1.5.3 Difference between an Agreement and a Contract

Agreement	Contract
1) Offer and its acceptance constitute an agreement.	1) Agreement and its enforceability constitute a contract.
2) An agreement may not create a legal obligation.	2) A contract necessarily creates a legal obligation.
3) Every agreement may not be a contract.	3) All contracts are agreements.
4) Agreement is not a concluded or a binding contract.	4) Contract is concluded and binding on the concerned parties.

Check Your Progress A

1) What is Law?

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2) Define contact.

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3) Define an agreement.

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4) What do you mean by legal obligation?

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5) State whether the following statements are True or False.

i) Law is the body of principles enforced by judiciary. ……..

ii) Business law is applicable to business community only. ……..

iii) Customs and usages are an important source of business law. ……..

iv) Law of contracts is the law of all obligations. ……..

v) All contracts are agreements. ……..

vi) There can be a contract without *consensus ad idem*. ……..

1.6 CLASSIFICATION OF CONTRACTS

Contracts can be classified on a number of bases. They are:

1) On the basis of creation

2) On the basis of execution

3) On the basis of enforceability

1.6.1 On the Basis of Creation

A contract may be (i) made in writing or by word of mouth or (ii) inferred from the conduct of the parties or circumstances of the case. The first category of contract is termed as 'express contract' and the second as 'implied contract'

i) **Express Contract**: An express contract is one where the terms are clearly stated in words, spoken or written. For example, A wrote a letter to B stating "I offer to sell my car for Rs. 30,000 to you", B accepts the offer by letter sent to A. This is an express contract. Similarly, when A asks a scooter mechanic to repair his scooter and the mechanic agrees, it is an express contract made orally by spoken words.

ii) **Implied Contract**: A contract may be created by the conduct or acts of parties (and not by their words spoken or written). It may result from a

continuing course of conduct of the parties. For example, where a coolie in uniform carries the luggage of A to be carried out of railway station without being asked by A to do so and A allows it, the law implies that A has agreed to pay for the services of the coolie. This is a case of an implied contract between A and the coolie. Similarly, when you board a bus or metro rail, an implied contract comes into being. You are bound to pay the prescribed fare.

There is another category of implied contracts recognised by the Contract Act known as quasi-contracts (Sections 68 to 72). Strictly speaking, a quasi-contract cannot be called a contract. It is regarded as a relationship resembling that of a contract. In such a contract the rights and obligations arise not by an agreement between the parties but by operation of law. For example, A, a trader, left certain goods at Bs house by mistake. B treated the goods as his own and consumed it. In such a situation, B is bound to pay for the goods even though he has not asked for the goods. You will learn about the quasi-contracts in detail in Unit 8.

1.6.2 On the Basis of Execution

On the basis of the extent to which the contracts have been performed, we may classify them as (i) executed contracts, and (ii) executory contracts.

i) **Executed Contracts**: It is a contract where both the parties have fulfilled their respective obligations under the contract. For example, A agrees to sell his book to B for Rs. 50. A delivers the book to B and B pays Rs. 50 to A. It is an executed contract.

ii) **Executory Contracts**: It is a contract where both the parties to the contract have still to perform their respective obligations. For example, A agrees to sell a book to B for Rs. 50. If the book has not been delivered by A and B has not paid the price, the contract is executory.

A contract may sometimes be partly executed and partly executory. It happens where only one of the parties has performed his obligation. In the example given above, if A has delivered the book to B but B has not paid the price. the contract is executed as to A and executory as to B.

On the basis of execution, a contract can also be classified as unilateral or bilateral. A unilateral contract is one in which only one party has to perform his obligation, the other party had fulfilled his part of the obligation at the time of the contract itself. For example, A buys a ticket from the conductor and is waiting in the queue for the bus. A contract is created as soon as the ticket is purchased. The other party is now to provide a bus wherein he could travel. A bilateral contract is one in which the obligations on the part of both the parties are outstanding at the time of the formation of the contract.

1.6.3 On the Basis of Enforceability

From the point of view of enforceability a contract may be (i) valid, (ii) void, (iii) voidable, (iv) illegal or (v) unenforceable. These terms shall be used quite frequently in this course. Hence, you must form a clear idea about their respective meanings.

i) **Valid Contract**: A contract which satisfies all the conditions prescribed by law is a valid contract. (These conditions are discussed in Section 1.7.) If

one or more of these elements is/are missing, the contract is either void, voidable, illegal or unenforceable.

ii) **Void Contract**: According to Section 2 (j) *A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable*. It is a contract without any legal effects and is a nullity. You should note that a contract is not void from its inception. It is valid and binding upon the parties when made, but subsequent to its formation, due to certain reasons, it becomes unenforceable and so treated as void. A contract may become void due to impossibility of performance, change of law or some other reasons. For example, A promised to marry B. Later on, B dies. This contract becomes void on the death of B. **A void contract should be distinguished from void agreement.** Section 2(g) says that *an agreement not enforceable by law is said to be void.* In the case of void agreement no contract comes into existence. Such an agreement confers no rights on any person and creates no obligations. It is void ab-initio i.e., from the very beginning. For example an agreement with a minor is void because a minor is incompetent to contract.

Now it should be clear to you that a void agreement is not the same thing as a void contract. A void agreement never matures into a contract, it is void from the very beginning. A void contract, on the other hand, was valid when it was entered into, but subsequently, because of one reason or the other, became void. **A contract cannot be void ab-inltio, it is only an agreement which can be void ab-initio.**

iii) **Voidable Contract:** According to Section 2(i) of the Contract Act, An agreement 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 others, is a voidable contract. Thus, a voidable contract is one which can be set aside or repudiated at the option of the aggrieved party. Until it is set aside or avoided by the party entitled to do so, it remains a valid contract. A contract is usually treated as voidable when the consent of a party has not been free i.e., it has been obtained either by coercion, undue influence, misrepresentation or fraud. The contract is voidable at the option of the party whose consent has been so caused. For example, A threatens to shoot B if he does not sell his new scooter to A for Rs. 5,000. B agrees. Here the consent of B has been obtained by coercion. Hence, the contract is voidable at the option of B, the aggrieved party. If, however, B does not exercise his option to set aside the contract within a reasonable time and if in the meanwhile a third party acquires a right in relation to the subject matter for some consideration, the contract cannot be avoided. For example, A obtains a ring by fraud. Here, B's consent is not free and therefore he can cancel this contract. But if, before this option is exercised by B, A sells the ring to C who acquires it after paying the price and in good faith, contract cannot be avoided. You should note that the option to set aside the contract on this ground is not available to the other party. Hence, **if the aggrieved party chooses to regain the contract, it remains enforceable by law**. If however, the aggrieved party avoids the contract, the other party is also freed from his obligation to perform the contract and if the party avoiding the contract has received any benefit under the contract, he must restore such benefit to the person from whom it was received (Section 64).

Distinction between Void Agreement and Voidable Contract

Void Agreement	Voidable Contract
1) It is void from the very beginning.	1) It remains valid till it is repudiated by the aggrieved party.
2) A contract is void if any essential element of a valid contract (other than free consent) is missing.	2) A contract is voidable if the consent of a party is not free.
3) It cannot be enforced by any party.	3) If the aggrieved party so decides, the contract may continue to be valid and enforceable.
4) Third party does not acquire any rights.	4) An innocent party in good faith and for consideration acquires good title before the contract is avoided.
5) Lapse of time will not make it a valid contract, it always remains void.	5) If it is not avoided within reasonable time, it may become valid.
6) Question of damages does not arise	6) The aggrieved party can also claim damages.

iv) **Illegal or unlawful contract**: The word 'illegal' means contrary to law. You know that contract is an agreement enforceable by law and therefore, it cannot be illegal. It is only the agreement which can be termed as illegal or unlawful. Hence, **it is more appropriate to use the term 'illegal agreement' in place of 'illegal contract'.**

An 'illegal agreement' is one which has been specifically declared to be unlawful under the provisions of the Contract Act or which goes against the provisions of any other law of the land. Such agreement cannot be enforced by law. For example, A agrees to pay Rs. 50,000 to B if B kills C. This is an illegal agreement because its object is unlawful. Even if B kills C, he cannot claim the agreed amount from A.

The term 'illegal agreement' is wider than the term 'void agreement'. **All illegal agreements are void but all void agreements are not necessarily illegal**. For example, an agreement to sell a scooter to the minor i.e. void but it is not illegal because the object of this agreement is not unlawful. The other important difference between the illegal and the void agreement relates to their effect on the transactions which are collateral to the main agreement. **In case of illegal agreements even the collateral agreements become void.** For example, A engages B to shoot C. To pay B, A borrows Rs. 10,000 from D who is aware of the purpose of the loan. In this case, there are two agreements – one between A and B and the other between A and D. Since the main agreement between A and B is illegal, the agreement between A and D which is collateral to the main agreement is also void. D cannot recover the money from A. Take another example. A borrows money from D to pay off his wagering (betting) debts to B. Here the main agreement is void (not illegal). Hence the agreement between A and D being a collateral agreement shall not be affected even

though D was aware of the purpose of the loan. From these examples, it should be clear to you that the agreements collateral to the illegal agreements are also void but the transactions collateral to void agreements are not affected in any way, they remain valid.

Difference between Void Agreement and Illegal Agreement

Void Agreement	Illegal Agreement
1) All void agreements are not necessarily illegal.	1) All illegal agreements are void.
2) Collateral transactions to a void agreement are not affected i.e., they do not become void.	2) Collateral transactions to an illegal agreements are also affected i.e., they also become void.
3) If a contract becomes void subsequently, the benefit received has to be restored to the other party.	3) The money advanced or thing given cannot be claimed back.

v) **Unenforceable contract:** It is a contract which is actually valid but cannot be enforced because of some technical defect. This may be due to non-registration of the agreement, non-payment of the requisite stamp fee, etc. Sometimes, the law requires a particular agreement to be in writing. If such agreement has not been put in writing, it becomes unenforceable. For example, an oral agreement for arbitration are unenforceable because the law requires that an arbitration agreement must be in writing. It is important to note that in most cases, such contracts can be enforced if the technical defect involved is removed. For example, if the document which embodies a contract is understamped, it will become enforceable if the requisite stamp is affixed.

Look at Figure 1.1. It gives a bird's eyeview of the different type of contracts.

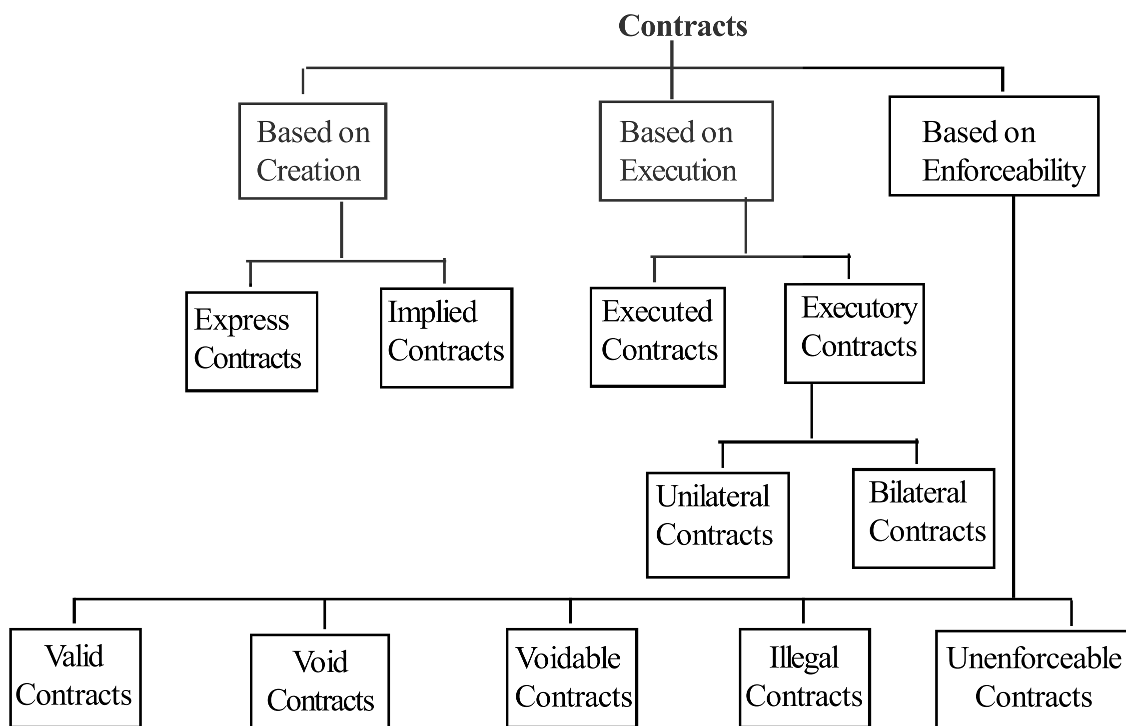

Fig. 1.1: Classification of Contracts

Check Your Progress B

1) What is a void contract?

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2) When is a contract voidable?

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3) What is an illegal agreement?

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4) State whether a contract is created in the following cases. Write 'Yes' or 'No'

   i) A boards a public vehicle for Agra. ……

   ii) A engages B to smuggle goods into India. ……

   iii) A invites B for dinner at his house. ……

   iv) A engages B to do cooking for Rs. 500. ……

5) Give your decision in case of the following problems in a word or two.

   i) A invites B to dinner. B accepts the invitation but fails to turn up. Can A sue B for the damages?

   ii) A agrees to marry B. B dies before the marriage takes place. What happens to the contract?

   iii) A promises to give a ring at the time of the marriage of his friend B. He fails to give the ring. Can B claim the ring?

   iv) A sold a scooter to B saying that it was a brand new scooter. In fact the scooter was not new. Can B avoid the contract?

   v) A promises to pay B Rs. 2,000 if B beats C. B beats C. Can B recover the amount from A?

1.7 ESSENTIALS OF A VALID CONTRACT

You have learnt that an agreement enforceable by law is a contract. An agreement in order to be enforceable must have certain essential elements.

According to Section 10, *All agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.* Thus, an agreement becomes a valid contract if it has the following elements.

1) Proper offer and its proper acceptance
2) Intention to create legal relationship
3) Free consent
4) Capacity of parties to contract
5) Lawful consideration
6) Lawful object
7) Agreement not expressly declared void
8) Certainty of meaning
9) Possibility of performance
10) Legal formalities

Let us now discuss these essential elements one by one.

1) **Proper offer and proper acceptance**: In order to create a valid contract it is necessary that there must be at least two parties, one making the offer and the other accepting it. The law has prescribed certain rules for making the offer and its acceptance that must be satisfied while entering into an agreement. For example, the offer must be definite and duly communicated to the other party. Similarly, the acceptance must be unconditional and communicated to the offerer in the prescribe mode, and so on. Unless such conditions with regard to the offer and the acceptance are satisfied the agreement does not become enforceable. You will learn about offer acceptance in detail in Unit 2.

2) **Intention to create legal relationship**: There must be an intention among the parties to create a legal relationship. If an agreement is not capable of creating a legal obligation it is not a contract. In case of social or domestic agreements, generally there is no intention to create legal relationship. For example, in an invitation to dinner there is no intention to create legal relationship and therefore, is not a contract. Similarly, certain agreements between husband and wife do not become contracts because there is no intention to create legal relationship. This point can well be illustrated by the famous case of **Balfour v. Balfour**. Mr. Balfour had promised to pay £30 per month to his wife living in England when she could not accompany him to Caulon where he was employed. Mr. Balfour failed to pay the promised amount. Mrs. Balfour filed a suit against her husband for breach of this agreement, It was held that she could not recover the amount as it was a social agreement and the parties never intended to create any legal relations.

   In commercial or business transactions the usual presumption is that the parties intend to create legal relations. However, this presumption may be negatived by express terms to the contrary. The case of **Rose & Frank**

Co. v. Crompton Brothers is relevant here. In this case there was an agreement between Rose & Frank Company and Crompton Brothers Ltd. whereby the former was appointed as selling agents in North America. One of the clauses in the agreement read, "This agreement is not entered into as a formal or legal, agreement and shall not be subject to legal jurisdiction in the law courts." It was held, that this agreement was not a legally binding contract as there was no intention to create legal relations.

You must note that whether intention to create legal relationship exists in an agreement or not is a matter for the court to decide which may look at the terms and conditions of the agreement and the circumstances under which the agreement was made

3) **Free consent:** For a contract to be valid, it is essential that there must be free and genuine consent of the parties to the contract. They must have made the contract of their own free will and not under any fear or pressure. 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.* In case the consent is obtained by any of the first four factors, the contract would be voidable at the option of the aggrieved party. But if the agreement is induced by mutual mistake which is material to the agreement, it would be void. You will learn about free consent in detail in Unit 4.

4) **Capacity of parties:** The parties to an agreement must be competent to contract i.e., they must be capable of entering into a contract. If any party to the contract is not competent to contract, the contract is not valid. Now the question arises as to who are competent to contract? Answer to this question is provided by 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.*

   From this section you will notice that in order to be competent to enter into a contract, the person should be a major (adult), should be of sound mind and he must not be declared disqualified from contracting by any law to which he is subject. Thus, the flaw in capacity may be due to minority, lunacy, idiocy, etc. If a party to a contract suffers from any of these flaws, the agreement, with a few exceptions, is not enforceable by law. This point has been discussed at length in Unit 3.

5) **Lawful consideration:** An agreement must be supported by consideration. Consideration means something in return. It is also defined as the price paid by one party to buy the promise of the other. However, this price need not always be in terms of money. For example, A agrees to sell his book to B for Rs. 50. Here the consideration for A is Rs. 50, and for B it is the book.

   The consideration may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something, The consideration may be past, present or future, consideration must be real i.e., it must have some value in the eyes of law. However, the consideration need not be adequate. For example, A sells his car worth Rs. 2,00,000 to B for Rs. 50,000 only. This is a valid promise provided the consent of A is free.

For a contract to be valid, the consideration should also be lawful. The consideration is considered lawful unless it is forbidden by law, or is fraudulent, or involves or implies injury to the person or property of another, or is immoral, or is opposed to public policy (Section 23). The law regarding consideration is discussed in detail in Unit 5.

6) **Lawful object:** The object of an agreement must be lawful. An agreement made for any act which is prohibited by law will not be valid. For example, if A rents out a house for use as a gambling den, the agreement is void because the object of the agreement is unlawful. If the object is unlawful for any of the reasons mentioned in Section 23, the agreement shall be void. Thus, the consideration as well as the object, of the agreement should be lawful.

7) **Agreement not expressly declared void:** The agreement must not have been expressly declared void under Contract Act. Sections 24 to 30 specify certain types of agreements which have been expressly declared void. They are agreement in restraint of marriage, agreement in restraint of legal proceedings, agreement in restraint of trade and agreement by way of wager.

   For example, A agreed to pay Rs. 10,000 to B if he (B) does not marry throughout this life. B promised not to marry at all. This agreement shall not be valid because it is in restraint of marriage which has been expressly declared void under Section 26.

   You should note that if an agreement possesses all other essential elements of a valid contract but belongs to the category of such agreements that have been expressly declared void by the Contract Act, no power on earth can make it a valid contract.

8) **Certainty of meaning:** Section 29 of the Contract Act provides that *Agreements, the meaning of which is not certain or capable of being made certain, are void.* Thus to make a valid contract it is absolutely essential that its terms must be clear and not vague or uncertain. For example, A agreed to sell 100 tonnes of oil to B. Here it is not clear what kind of oil is intended to be sold. Therefore, this agreement is not valid on the ground of uncertainty. If, however, the meaning of the agreement could be made certain from the circumstances of the case, it will be treated as a valid contract. In the example given above if we know that A and B are dealers in mustard oil only, then the agreement shall be enforceable because the meaning of the agreement could be easily ascertained from the circumstances of the case.

9) **Possibility of performance:** The terms of the agreement must also be such as are capable of performance. An agreement to do an act impossible in itself is void (Section 56). If the act is impossible of performance, physically or legally, the agreement cannot be enforced by law. The reason is very simple. We make an agreement with a view to perform it and if the performance is not possible, what is the idea of making such agreements? For example, A promises to B that he will enclose some area between two parallel lines or that he will run at a speed of 200 km per hour or that he will bring gold from the moon. All these acts are such which are impossible of performance and therefore the agreement is not treated as valid.

10) **Legal formalities**: You have learnt that an oral agreement is as good as is a written agreement. The Contract Act does not require that a contract must be in writing to be valid. But, in some cases the Act has specified that the agreement must be made in writing, some agreements must be registered as well. For example, a promise to pay a time barred debt must be in writing and an agreement for a sale of immovable property must be in writing and registered under the Transfer of Property Act, 1882. In such a situation, the agreement must comply with the necessary formalities as to writing, registration, etc. If these legal formalities are not carried out, then the contract is not enforceable by law.

After discussing the essential elements of a valid contract, it should now be clear to you that all these elements must be present in an agreement so that it becomes a valid contract. If any one of them is missing or absent, the agreement will not be enforceable by law.

1.8 LET US SUM UP

Law is the body of rules with regard to human conduct and actions which can be enforced in a court of law. There are several branches of law such as international law, constitutional law, criminal law, civil law, etc. Business law is an important branch of civil law which deals with laws relating to business transactions. The main sources of business law in India are the English laws, Indian statute laws, past judicial decisions, local customs and usages. The law of contracts is the most important part of business law which deals with general rules relating to all types of contracts and covers the special provisions relating to some specific contracts.

A contract is defined as an agreement enforceable by law. Hence, it consists of two main elements: (i) an agreement and (ii) its enforceability by law.

Contracts can be classified according to their (i) creation, (ii) execution, and (iii) enforceability. From the point of view of creation a contract may be either express or implied. From the point of view of execution it may be executed/ executory or it may be unilateral/ bilateral, and from the point of view of enforceability it may be a valid, void, voidable, illegal or unenforceable contract.

An agreement not enforceable by law is said to be a 'void agreement'. The term 'void contract' refers to an agreement which was valid when it was entered into but become void later on because of one reason or the other. A 'voidable contract' is one which is voidable (can be avoided) at the option of one party (aggrieved party) and not the other. An 'illegal agreement' is one where the object or the consideration is unlawful. Such agreement is also void and therefore not enforceable by law. An 'unenforceable agreement' is one which is valid but cannot be enforced because of some technical defect.

For an agreement to become a contract enforceable by law, it must have certain essential elements. These are: (i) there must be proper offer and its proper acceptance, (ii) there must be an intention to create legal relationship, (iii) the consent of the parties must be free, (iv) the parties must be competent to contract, (v) it must be supported by lawful consideration, (vi) the object of the agreement must be lawful, (vii) the agreement must not have been expressly declared void, (viii) the terms of the agreement must be certain and unambiguous,

(ix) the act involved should be such as is capable of performance, and (x) if there are certain formalities like registration, etc., they should be duly complied with.

1.9 KEY WORDS

Agreement: Every promise and set of promises, forming consideration for each other.

Bilateral Contract: A contract by which both the parties have yet to perform their respective promises.

Consensus ad-idem: Parties agreeing upon the same thing in the same sense.

Contract: An agreement enforceable by law.

Express Contract: An agreement made in writing or by word of mouth.

Illegal Agreement: An agreement the object of which is unlawful.

Implied Contract: An agreement inferred from the conduct of the parties.

Obligation: An undertaking to do or to abstain from doing some definite act.

Promise: An accepted proposal.

Unenforceable Agreement: An agreement which, though valid, cannot be enforced due to some technical defect.

Unilateral Contracts: A contract in which only one party has still to fulfil his obligation, while the other party has already fulfilled his own at the time of the formation of the contract itself.

Valid Contract: An agreement enforceable by law is a valid contract.

Void Agreement: An agreement not enforceable by law.

Void ab-initio: Something which is void from the very beginning.

Void Contract: An agreement which was valid when entered into but which subsequently becomes void.

Voidable Contract: A contract which can be avoided at the option of the aggrieved party.

1.10 ANSWERS TO CHECK YOUR PROGRESS

A) 5) i) True ii) False iii) True iv) False v) True vi) False

B) 4) i) Yes ii) No iii) No iv) Yes

5) i) No ii) contract becomes void iii) No iv) Yes v) No

1.11 TERMINAL QUESTIONS/EXERISES

1) What is a contract? Explain the essentials of a valid contract.

2) Comment on the following statements.

   a) "All contracts are agreements but all agreements are not contracts."

b) "The law of contract is not the whole law of agreements nor is it the whole law of obligations."

c) "In commercial and business agreements, the presumption is that the parties intend to create legal relations."

3) Distinguish between

i) Void and Voidable contracts

ii) Void and Illegal agreements

4) Answer the following questions giving suitable reasons:

i) A invites B to stay with him during winter vacation. B accepts the invitation and informs A accordingly. When B reaches A's house, he finds it locked and he has to stay in a hotel. Can B claim damages from A?

(Hint: B cannot claim any damages from A. It is a social agreement and there is no intention to create legal obligation.)

ii) A polished B's shoes without being asked by B to do so, B does not make any attempt to stop A from polishing the shoes. Is B bound to make payment to A?

(Hint: B is bound to pay A because he has accepted the offer by conduct.)

iii) A makes a promise to his son to give him pocket money of Rupees five hundred every month. After three months A stops making the payment. Advise the son.

(Hint: Son cannot compel his father as there was no intention to create legal relationship.)

iv) A promises to obtain for B an employment in a government office and B promises to pay Rs. 5,000 to A. Is the agreement valid?

(Hint: It is not valid because the object of the agreement is unlawful.

v) A promises to give a gift of Rs. 10,000 to B on his mariage. A fails to keep his promise. Can B recover the money.

(Hint: B cannot recover the money because there is no consideration from B.)

vi) A agreed to sell a particular horse to B. Later on it was discovered that the horse was dead at the time of making the contract. Advise the parties.

(Hint: The contract is not valid because there is no consent. Both the parties were under a mistake of fact regarding existence of the subject-matter).

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

UNIT 2 OFFER AND ACCEPTANCE

Structure

2.0 Objectives

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- 2.2.3 To Whom an Offer is Made?
- 2.2.4 Legal Rules for a Valid Offer
- 2.2.5 Cross Offers
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- 2.3.1 What is an Acceptence?
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- 2.3.3 How is an Acceptance Made?
- 2.3.4 Legal Rules for a Valid Acceptance

2.4 Communication of Offer and Acceptance

- 2.4.1 Communication of Offer
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2.5 Revocation of Offer and Acceptance

- 2.5.1 Revocation of Offer
- 2.5.2 Revocation of Acceptance
- 2.5.3 Communication of Revocation

2.6 Lapse of an Offer

2.7 Let Us Sum Up

2.8 Key Words

2.9 Answers to Check Your Progress

2.10 Terminal Questions/Exercises

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2.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of offer and acceptance;
- describe the legal rules for a valid offer and acceptance;
- distinguish offer from tender and cross offer;
- describe the rules regarding communication of offer and acceptance ;
- describe the rules regarding revocation of offer and acceptance; and
- explain when an offer lapses.

2.1 INTRODUCTION

In Unit 1 you learnt that an agreement enforceable by law is a contract and that an agreement to become enforceable by law must have certain essential elements. You also learnt that there must be at least two parties to an agreement, one making an offer and the other accepting that offer. Thus, an offer and its acceptance are the starting points in the making of an agreement. In this unit you will learn about the various rules regarding a valid offer and a valid acceptance. You will also learn how an offer and its acceptance are to be communicated and when they can be revoked.

2.2 OFFER

2.2.1 What is an Offer?

You have learnt in Unit 1 that for making a valid contract there must be a lawful offer and a lawful acceptance of that offer. An offer is also called 'Proposal'. The words 'proposal' and 'offer' are synonymous and are used interchangeably. Section 2(a) defines the term 'proposal' as follows:

"When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal."

From the above definition of offer you will notice that an offer involves the following elements.

i) It must be an expression of readiness or willingness to do or to abstain from doing something. Thus, it may involve a 'positive' or a 'negative' act. For example, A offers to sell his book to B for Rs. 50. A is making a proposal to do something i.e., to sell his book. It is a positive act on the part of the proposer A. On the other hand, when A offers not to file a suit against B if the latter pays A the outstanding amount of Rs. 10,000, the act of A is a negative one i.e., he is offering to abstain from filing a suit.

ii) It must be made to another person. There can be no 'proposal' by a person to himself.

iii) It must be made with a view to obtain the assent of that other person to such actor abstinence. Thus a mere statement of intention – "I may sell my furniture if I get a good price" is not a proposal.

The person making the offer is called the 'offerer' or the 'promisor' and the person to whom it is made is called the 'offeree'. When the offeree accepts the offer, he is called the 'acceptor' or the 'promisee'. For example, Ram offers to sell his scooter to Prem for Rs. 10,000 This is an offer by Ram. He is the offerer or the promisor. Prem to whom the offer has been made is the offeree and if he agrees to buy the scooter for Rs. 10,000 he becomes the acceptor or the promisee.

2.2.2 How is an Offer Made?

An offer can be made by any act which has the effect of communicating it to the other. An offer may either be an 'express offer' or an 'implied offer'

Express Offer: When an offer is made by words, spoken or written, it is termed as an express offer. When A says to B that he wants to sell his book to B for Rs. 50, it is an express offer. Similarly, when A writes a letter to B offering to sell his car to him for Rs. 50,000, it is also an express offer by A. The oral offer may be made either in person or over telephone. Section 9 of the Contract Act reads: "In so far as the proposal or acceptance of any promise is made in words, the promise is said to be express."

Implied Offer: It is an offer which is not made by words spoken or written. An implied offer is one which is inferred from the conduct of a person or the circumstances of the particular case. For example, public transport like DTC in Delhi or BEST in Bombay runs buses on different routes to carry passengers who are prepared to pay the specified fare. This is an implied offer. Similarly, when a coolie picks up your luggage to carry it from railway platform to the taxi, it means that the coolie is offering his service for some payment. This is an implied offer by the coolie. A bid at an auction is an implied offer to buy. Section 9 says that *"In so far as such proposal or acceptance is made otherwise than in words, the promise is said to be implied."*

2.2.3 To Whom an Offer is Made?

According to law, an offer can be accepted only by the person to whom it is made. Hence, we must know how to identify the person to whom the offer has been made. From this point of view, an offer may be 'specific' or 'general'. When an offer is made to a definite person or particular group of persons, it is known as **specific offer** and it can be accepted only by that definite person or that particular group of persons to whom it has been made. For example, A offered to buy certain goods from B at a certain price. This offer is made to a definite person B. Therefore, if goods are supplied by P, it will not give rise to a valid contract (**Boultan v. Jones**).

On the other hand, if an offer which is not made to a definite person, but to the world at large or public in general, it is called a general offer. A general offer can be accepted by any person by fulfilling the terms of the offer. Offer of reward made by way of advertisement for finding lost articles is the most appropriate example of a general offer. For example, B issues a public advertisement to the effect that he would pay Rs. 100 to anyone who brings hack his missing dog. This is a general offer and any member of the public can accept the said offer by finding the lost dog. Similarly, a company advertised that it would pay £ 100 to anyone who contacts influenza after using the smoke balls of the company for a certain period according to the printed directions. Mrs. Carlill used the smoke balls according to the directions of the company but subsequently she contacted influenza. She filed a suit for the reward. It was held that she would recover the reward as she had accepted the offer by complying with the terms of the offer (**Carlill v. Carbolic Smoke Ball Company**).

When an offer is made to a particular group of persons, it may be accepted by any member of that group.

2.2.4 Legal Rules for a Valid Offer

An offer or proposal made by a person cannot legally be regarded as an offer unless it satisfies the following conditions.

1) **Offer must intend to create legal relations**: An offer will not become a promise even after it has been accepted unless it is made with a view to create legal obligations. It is so because the very purpose of entering into an agreement is to make it enforceable in a court of law. **A mere social invitation cannot be regarded as an offer because if such an invitation is accepted it will not give rise to any legal relationship.** For example, A invites his friend B to a dinner and B accepts the invitation. If B fails to turn up for dinner, A cannot go to the court to claim his loss. In social agreements the presumption is that the parties do not intend to create legal relationship. This point is very well illustrated by the case of **Balfour v. Balfour** which has been discussed in Unit 1 (Section 1.7). In business agreement, however, it is presumed that it will be followed by legal consequences. But if the parties to a business agreement also agree that none of them shall go to court in case of its breach, then even such an agreement will not be treated as a contract (refer to the case of **Rose & Frank Co. v. Crompton Brothers** - Section I.7 of Unit 1).

2) **Terms of offer must be certain, definite and not vague**: No contract can be formed if the terms of the offer are vague, loose and indefinite. The reason is quite simple. When the offer itself is vague or loose or uncertain, it will not be clear as to what exactly the parties intended to do. A vague offer does not convey what it exactly means. For example, A promises to buy one more horse from B if the horse purchased earlier proves lucky. This promise cannot be enforced because it is loose and vague. Similar is the case when A agrees to sell his car to B for Rs. 50,000 after making necessary repairs. What are necessary repairs is a debatable question and as such the offer is not valid.

   If, however, the terms of the offer are capable of being made certain, the offer is not regarded as vague. For example, A offers to sell to B "a hundred quintals of oil". The offer is uncertain as there is nothing to show what kind of oil is intended to be sold. But, if A is a dealer in coconut oil only, it is quite clear that he wants to sell coconut oil. Hence, his offer is not vague. It is a valid offer.

   Sometimes, the parties agree to enter into a contract on some future date. Such agreement is not valid because the terms of the offer are uncertain and they are yet to be settled. The law does not allow making of an agreement to agree in future. In the case of **Loftus v. Roberts,** an actress was engaged for a provincial tour. The agreement provided that if the party went to London, the actress will be engaged at a salary to be mutually agreed upon. It was held that there was no contract as the terms were not definite.

3) **The offer must be distinguished from a mere declaration of intention**: Sometimes a person may make a statement without any intention of creating a binding obligation. Such statement or declaration only indicates that he is willing to negotiate and an offer will be made or invited in future. For example an auctioneer advertised in a newspaper that a sale of office furniture will be held on a certain date. A person with the intention to buy furniture came from a distant place for the auction, but the auction was cancelled. He cannot file a suit against the auctioneer for his loss of time and expenses because the advertisement was merely a declaration of intention to hold auction, (**Harris v. Nickerson**). Similarly, a notice that goods will

be sold by tender does not amount to an offer. When a person calls for tenders, it is only an attempt to ascertain whether an offer can be obtained within such a margin as the seller is willing to adopt (**Spencer v. Harding**). The tenderers by submitting their tenders make offers and it is for the person inviting tenders to accept them or not. In case of **Farina v. Fickus**, a father wrote to his would be son-in-law that his daughter would have a share of what he left. It was held that the letter was a mere statement of intention and not an offer.

4) **Offer must be distinguished from an invitation to offer**: An offer must be distinguished from an invitation to receive an offer or to make on offer or to negotiate. In the case of invitation to offer there is no intention on the part of the person sending out the invitation to obtain the assent of the other party to such invitation. On the other hand, offer is a final expression of willingness by the offerer to be bound by his promise, should the other party choose to accept it. In case of an invitation to offer, his aim is to merely circulate information of his readiness to negotiate business with anybody who on such information comes to him. **An invitation to offer is not an offer in the eyes of law and does not become a promise on acceptance**.

You must have noticed that shopkeepers generally display their goods in showcases with price tags attached. The shopkeeper in such cases is not making an offer so that you can accept it. He is in fact inviting you to make an offer which he may or may not accept. You cannot compel the shopkeeper to sell the goods displayed in the showcase at the market price. Similarly, quotations, catalogues, price list, advertisements in a newspaper for sale or a circular sent to prospective buyers do not constitute an offer.

In the case of **Pharmaceutical Society of Great Britain v. Boots Case Chemists Ltd.**, goods were displayed in the shop for sale with price tags attached on each article. The customers used to select goods and take them to the cashier for the payment of the price. It was held, that in this case there was only an invitation to offer and not an offer itself. The shopkeeper cannot be compelled to sell the goods at the price indicated. The contract was made, not when the customer selected the goods, but when the cashier accepted the offer to buy and receive the price. Similarly, a prospectus issued by a company for subscription to its shares by the members of the public is only an invitation to offer. When a person fills up the form and deposits it with the bank alongwith the application money, he is simply making an offer to buy shares. Now it is for the company to accept his offer in full or partially, or reject it outright.

5) **The offer must be communicated**: An offer must be communicated to the person to whom it is made. The first part of the definition of proposal emphasises this fact by saying that "When one person signifies to another his willingness to or to abstain.............." It means that an offer is complete only when it is communicated to the offeree. You should note that a person can accept the offer only when he knows about it. An offer accepted without his knowledge does not confer any legal rights on the acceptor. There can be no valid acceptance unless there is knowledge of the offer.

In the case of **Fitch v. Snedakar**, S offered a reward to any one who returns his lost dog. F brought the dog without any knowledge of the offer of reward. It was held that F was not entitled to the reward because F cannot be said to have accepted the offer which he was not aware of. In

another important case of **Lalman Shukla v. Gauri Dutt**, G sent his servant E to trace his lost nephew. When the servant had left, G announced a reward of Rs. 501 to anyone who traces the boy. L found the boy and brought him home. When E came to know of the reward, he decided to claim it. It was held that L was not entitled to the reward because he did not know about the offer when he found the missing boy. It is also necessary that the offer is communicated by the offerer himself or by his authorised agent. If a person comes to know about the offer from some other source, he cannot make it a binding contract by accepting it. For example, A writes a letter to B at Mumbai offering to sell his house. This letter is misplaced and it never reaches B. But, a common friend P had informed B about the said letter of A containing the offer. B sends his letter of acceptance to A. In such a situation, no contract will be formed.

6) **Offer should not contain a term the non-compliance of which would amount to acceptance**: The offer should not impose on the offeree an obligation to reply. While making the offer the offerer cannot say that if the offer is not accepted before a certain date it will be presumed to have been accepted. Unless the offeree sends his reply, no contract will arise. For example, A writes to B "I offer to sell my scooter to you for Rs. 7,000. If I do not receive a reply by Wednesday next, I shall assume that you have accepted the offer." If B does not reply, it shall not imply that he has accepted the offer. Hence, there will be no contract. However, the offerer can lay down the mode by which the acceptance is to be communicated.

7) **Special terms or conditions in an offer must also be communicated**: The offerer is free to lay down any terms and conditions in his offer, and if the other party accepts the offer then he will be bound by those terms and conditions. The important point is that if there are some special terms and conditions they should also be duly communicated. **The question of special terms arises generally in case of standard form of contracts**. For example, the Life Insurance Corporation of India has printed form of contracts containing large number of terms and conditions. Similarly, standard contracts are made with railways, shipping companies, banks, hotels, drycleaners etc. Such big companies are in a position to exploit the weakness of the individual by including certain terms and conditions in the contract which limit their liability. In order to protect the interest of the general public it is provided that the special terms of the offer must be duly brought to the notice of the offeree. If this is not done the offeree will not be bound by those terms. This can be done either by expressly communicating the special terms of by giving a reasonable notice about the existence of the special terms i.e., by drawing his attention to them by printing in red ink or bold letters 'for conditions see back' or 'P.T.O.' on the face of the printed form or ticket. If this is not done, the offeree will not be bound by them.

The leading case on this point is that of **Henderson v. Stevenson**. In this case A purchased a steamer ticket for travelling from Dublin to Whitehaven and this fact was printed on the face of the ticket. On the back of the ticket certain conditions were printed, one of which excluded the liability of the company for loss, injury or delay to the passenger or his luggage. A never looked at the back of the ticket and there was nothing to draw his attention to the conditions printed on the back side. His luggage was lost due to the

negligence of the servants of the shipping company. It was held that A was entitled to claim compensation for this loss of his luggage in spite of the exemption clause because there was no indication on the face of the ticket to draw his attention to the special terms printed on the back of the ticket.

You must note that if the special terms and conditions have been brought to the notice of the offeree, he will be bound by them even if he has not read them or is an illiterate. In the case of **Parker v. South Eastern Railway Company**, P deposited his bag in the cloakroom at a railway station. On the face of the receipt the words "see back" were printed. One of the conditions printed on the back limited the liability of the railway company for any package to £10. The bag was lost and P claimed £24. Sh. 10, the actual value of the bag. P admitted knowledge of the conditions printed on the back, but denied having read it. It was held that P was bound by the print on the back side even though he had not read them because the railways had given reasonably sufficient notice on the face of the ticket as to the existence of conditions. Therefore, P could recover £10 only.

The same rule is applicable even where the special conditions are printed in a language which the acceptor does not understand provided his attention has been drawn to them in a reasonable manner. In such a situation, it is the acceptor's duty to ask for the translation of the conditions before accepting the offer and if he did not ask, he is presumed to know them and he will be bound by them.

You must also note that the special terms and conditions should be brought to the knowledge of the offeree before the contract is concluded and not afterwards. A subsequent communication will not bind the acceptor unless he himself agrees thereto. For example, a couple hired a room in a hotel for a week. When they entered the room they found a notice on the wall disclaiming the owners liability for damage, loss or theft of articles. Some of their items were stolen. The owner of the hotel was held liable since the notice was not a part of the contract as it came to the knowledge of the client after the contract has been entered into. **(Olley v. Marlborough Court Ltd.)**

Finally, the terms and conditions must be reasonable. A term is considered to be unreasonable if it defeats the very purpose of the contract or if it is against the public policy. Thus, if the terms and conditions in a standardised contract are unreasonable, then the other party will not be bound by them. For example, if a drycleaner limits his liability to 20 per cent of the market price of the article in case of loss, the customer will not be bound by this conditions because it means that the drycleaner can purchase garments at 20 per cent of their price. **(Lilly White V. Mannuswamy)**

2.2.5 Cross Offers

Two offers which are similar in all respects, made by two parties to each other, in ignorance of each other's offer are known as 'cross offers'. **Cross offers do not amount to acceptance of one's offer by the other and as such no contract is concluded.** For example, A of Delhi, by a letter offers to sell his house to B of Mumbai for Rs. 10 lakh. At the same time, B of Mumbai also makes an offer to A to buy A's house for Rs. 15 lakh. The two letters cross each other. There is no concluded contract between A and B because both the parties

are making offers. If they want to conclude a contract, at least one of them must send his acceptance to the offer made by the other.

2.2.6 Standing Offers

Sometimes an offer may be of a continuous nature. In that case it is known as standing offer. **A standing offer is in the nature of a tender**. Sometimes a person or a department or some other body requires certain goods in large quantities from time to time. In such a situation, it usually gives an advertisement inviting tenders.

An advertisement inviting tenders is not an offer but a mere invitation to offer. It is the person submitting the tender to supply goods or services who is deemed to have made the offer, when a particular tender is accepted or approved, it becomes a standing offer. **The acceptance or approval of a tender does not however, amount to acceptance of the offer.** It simply means that the offer will remain open during a specified period and that it will be accepted from time to time by placing specific orders for the supply of goods. Thus each order placed creates a separate contract. The offerer can however withdraw his offer at any time before an order is placed with him. Similarly, the party who has accepted the tender is also not bound to place any order unless there is an agreement to purchase a specified quantity. For example, A agrees to supply coal of any quantity to B at a certain price as will be ordered by B during the period of 12 months. It is a standing offer. Each order given by B will be an acceptance of the offer and A will be bound to supply the ordered quantity of coal. A can however, revoke the offer for future supplies at any time by giving a notice to the offeree **(Gani Lalif V. Mani Lal).**

Check Your Progress A

1) What is an offer?

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....

2) What do your mean by a general offer?

....

....

....

3) What happens if an offer is not accepted in the prescribed mode?

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....

4) Fill in the blanks :

   i) An offer made by words spoken or written is known as .... offer

   ii) Terms of an offer must be ....

   iii) An invitation to make an offer is not the same thing as ....

   iv) A specific offer can be accepted by ....

   v) An agreement to enter into a contract in future is .... a binding agreement.

5) State whether the following statements are 'True or False'.

   i) An offer made to the world at large is called a specific offer. ....

   ii) An advertisement to sell goods by auction is an offer. ....

   iii) A social invitation, if accepted, does not create any legal obligations. ....

   iv) An advertisement offering reward to anyone who finds the lost dog of the advertiser is not an offer. ....

   v) Special terms and conditions of an offer may be communicated later on. ....

   vi) There is a counter offer when the offeree makes some query. ....

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2.3 ACCEPTANCE

2.3.1 What is an Acceptance?

You have learnt that when an offer is accepted, it results in an agreement. Let us now study what exactly an acceptance is. Acceptance is an expression by the offeree of his willingness to be bound by the terms of the offer. This results in the establishment of legal relations between the offerer and offeree. Section 2(b) of the Indian Contract Act defines the term 'acceptance' as "*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.*" For example, A offers to sell his book to B for Rs. 50. B agrees to buy the book for Rs. 50. This is an acceptance of A's offer by B.

2.3.2 Who Can Accept?

An offer can be accepted only by the person or persons to whom it is made. An offer made to a particular person (specific offer) can be accepted only by him and none else. 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. In the case of **Boulton v. Jones**, A sold his business to B but this fact was not known to an old customer C. C sent an order for goods to A by name. B supplied the goods to C. It was held that there was no contract between B and C because C never made any

offer to B. If an offer is made to the world at large (general offer) any person can accept the offer provided he has the knowledge of the offer. You have seen in **Carlill v. Carbolic Smoke Ball Co's** case that the lady accepted the offer by using the smoke balls. Similarly, in case a reward has been offered for giving information about missing person or a lost article, any person who gives the necessary information first, shall be entitled to the reward.

2.3.3 How is an Acceptance Made?

You know that an offer may be either express or implied. Similarly, the acceptance may also be either express or implied. When the acceptance is given by words spoken or written, it is called an '**express acceptance**'. For example, A offers to sell his book to B for Rs. 50. B may accept this offer by stating so orally or by writing a letter to A. The acceptance may also be implied by conduct. For example, A offers a reward of Rs. 1,000 to anyone, who traces his lost dog. B, who was aware of this offer, finds the dog, he is entitled to the reward as he accepted the offer by doing the required act. Take another example. A enters into DTC bus for going to New Delhi, Railway Station. This is an implied acceptance by A and he is bound to pay the fare.

2.3.4 Legal Rules for a Valid Acceptance

The acceptance of an offer to be effective must fulfil certain conditions. These are:

1) **Acceptance must be absolute and unqualified**: Section 7 (1) of the Indian Contract Act provides that *'In order to convert a proposal into a promise, the acceptance must be absolute and unqualified .... .'* This is so because a qualified and conditional acceptance amounts to a counter offer leading to the rejection of the original offer. No variation should be made by the offeree in the terms of offer. If while giving acceptance, any variation is made in the terms of the offer the acceptance will not be valid and there will be no contract. For example, A offers to sell his scooter to B for Rs. 8,000 and B agrees to buy it for Rs. 7,500. It is a counter offer and not an acceptance. If, later on, B is ready to pay Rs. 8,000 A is not bound to sell his scooter, because B's counter offer has put an end to the original offer.

   Further an offer must be accepted in toto. If only a part of the offer is accepted the acceptance will not be valid. For example, A offers to sell 100 quintals of wheat to B at a certain price. B accepts to buy 70 quintals only. It is not a valid acceptance since it is not for the whole of the offer. Thus, an offer should be accepted as it is, without any reservations, variations or conditions. Any variation, howsoever unimportant it may be, makes the acceptance invalid.

   In another case M offered to sell land to N at £ 280. N accepted and enclosed £ 80, with a promise to pay the balance by monthly balance of £ 50 each. Held there was no contract since the acceptance was qualified. **(Neale v. Merrett)**

   Sometimes, a person may accept the offer **"subject to a contract"** or **"subject to formal contract"** or **"subject to contract to be approved by the solicitors".** In such cases no contract arises because a condition remains to be performed in the future. For example, A's bid was provisionally accepted at an auction sale. The acceptance was 'subject to confirmation'.

Before confirmation, however, A withdrew his bid. It was held that because acceptance was not absolute, it was subject to confirmation, A can withdraw his bid before it is confirmed.

2) **Acceptance must be in the prescribed manner**: Where the offerer has prescribed a mode of acceptance, it must be accepted in that very manner. If the offer is not accepted in the prescribed manner it is up to the offerer to accept or reject such acceptance. But when the acceptance is not in the prescribed manner and the offerer wants to reject it, he must inform the acceptor within a reasonable time that he is not bound by acceptance since it is not in the prescribed manner. If he does not do so within a reasonable time, he will be bound by the acceptance.

   For example, A makes an offer to B and says "send your acceptance by e-mail, B sends his acceptance by a letter. A can refuse acceptance on the ground that it was not accepted in the prescribed manner. But, if A fails to inform B within a reasonable time he will be deemed to have accepted the acceptance it will result in the formation of a valid contract. If, however, no mode has been prescribed, it should be accepted in some usual and reasonable manner. This expression means the ordinary practice followed in a particular trade or business or place.

3) **Acceptancee must be communicated**: You have learnt in the definition of acceptance that it should be signified. In other words, the acceptance is complete only when it has been communicated to the offerer. **A mere mental acceptance, not evidenced by words or conduct, is no acceptance.** In **Brogen v. Metropolitan Railway Co.'s** case an offer to supply coal to the railway Co. was made. The manager wrote on the letter 'accepted', put it in his drawer and forgot all about it. It was held that no contract was made because acceptance was not communicated.

   Communication of acceptance does not mean that the offerer must come to know about the acceptance. Even if the letter of acceptance is lost in transit or delayed, the offerer is bound by the acceptance because the acceptor has done all that is required of him.

   You should note that the offerer, while making an offer, cannot impose a burden on the other party to communicate his refusal or rejection. He can certainly prescribe the manner in which the offer is to be accepted. But, he cannot lay down the manner in which it is to be refused. For example, the offerer cannot say that if he does not hear anything from the other party within seven days, the offer will be deemed to have been accepted. This point can be illustrated by the well-known case of **Felthouse v. Bindley**. In this case, F offered by a letter to buy his nephew's horse for £ 30 saying, "If I hear no more about him, I shall consider the horse is mine". The nephew sent no reply at all but told Bindley, his auctioneer, not to sell that particular horse as he intends to sell it to his uncle. Bindley, however, sold the horse by mistake. F sued the auctioneer for conversion. It was held that F will not succeed as his nephew had not communicated acceptance and hence there was no contract.

4) **Acceptance must be communicated by a person who has the authority to accept:** For an acceptance to be valid it should be communicated by the offeree himself or by a person who has the authority to accept. Thus, if

acceptance is communicated by an unauthorised person, it will not give rise to legal relations. The case of **Powell v. Lee** can be mentioned in support of this point. In this case P applied for the post of a headmaster in a school. The managing committee passed a resolution appointing P to the post but this decision was not communicated to P. However, a member of the managing committee, in his individual capacity and without any authority, informed P about the decision. Subsequently, the managing committee cancelled its resolution and appointed someone else. P filed a suit for breach of contract. It was held that he was not informed about his appointment by some authorised person, hence there was no communication of acceptance.

5) **Acceptance must be made within the time prescribed or within a reasonable time**: Sometimes the offerer while making the offer fixes the period within which the offer should be accepted. In such a situation, the acceptance must be given within the prescribed time and if no time is prescribed, it should be accepted within a reasonable time. What is the reasonable time depends upon the facts of the case. Where an offer to buy shares of a company was made in June but the acceptance was communicated in November, it was held that because acceptance was not given within a reasonable time the offer had elapsed. **(Ramagate Victoria Hotel Co. v. Montefiore)**.

6) **Acceptance must be given before the offer lapses or is withdrawn**: The acceptance must be given while the offer is in force. Once an offer has been withdrawn or stands lapsed, it cannot be accepted. For example, A offered, by a letter, to sell his car to B for Rs. 40,000. Subsequently, A withdraws his offer by an e-mail, which was duly received by B. After the receipt of the e-mail, B sends his acceptance to A. This acceptance is not valid. You will learn about the rules relating to lapse of an offer later in this unit.

Check Your Progress B

1) Define 'Acceptance'.

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2) What happens if the acceptance is not according to the mode prescribed?

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....

3) Fill in the blanks:

   i) An acceptance to be valid must be absolute and ....

   ii) An offer can be accepted by ....

   iii) Acccptance must be made in the ....’. ....manner.

   iv) If the acceptance is not given within a reasonable time, ...

   v) If the offeree remains silent, it means that he has .... the offer.

4) State whether the following statements are True or False.

   i) A specific offer can be accepted by anyone. ....

   ii) Silence amounts to acceptance of the offer. ....

   iii) Partial acceptance is invalid. ....

   iv) A rejected proposal cannot be accepted unless it is renewed. ....

   v) Acceptance may be communicated by any person. ....

2.4 COMMUNICATION OF OFFER AND ACCEPTANCE

You have learnt that offer and acceptance have to be communicated. Unless an offer is communicated it cannot be accepted. Similarly, an acceptance which is not communicated does not create any legal relations. Now the question arises as to when the communication of offer and acceptance is regarded as complete so as to bind the concerned parties.

When the contracting parties are face to face, there is no problem regarding communication, because there is instantaneous communication of the offer and its acceptance. The problem arises when parties are at a distance from each other and they have to do it through post. In such a situation, it is very important for us to know the exact time when communication of the offer and acceptance is complete because as soon as the communication is complete the parties loose the right of withdrawal or revocation. Let us now take up the rules regarding the communication of the offer and acceptance.

2.4.1 Communication of Offer

According to Section 4 of the Contract Act, the communication of an offer is complete when it comes to the knowledge of the person to whom it is made i.e., when the letter containing the offer reaches the offeree. For example, A of Delhi sends a letter by post to B of Hydrabad offering to sell his house for Rs. 20 lakh. The letter is posted on April 5, and this letter reaches B on April 7. The communication of the offer is complete on April 7.

In the above example, if the letter containing the offer never reaches B, but B comes to know about the proposal from some other source and sends his acceptance, it will not amount to proper communication of the offer and so no contract will arise.

2.4.2 Communication of Acceptance

The rules regarding communication of acceptance have to be studied from the point of view of offerer and as well as the offeree because the communication of acceptance is complete at different times for the offerer and the offeree.

According to Section 4 of the Contract Act, "the communication of acceptance is complete: (a) as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of the acceptor, and (b) as against the acceptor, when it comes to the knowledge of the proposer. **Thus, the offerer becomes bound by the acceptance as soon as the letter of acceptance is duly posted by the acceptor, but the acceptor is bound by his acceptance only when the letter of acceptance reaches the offerer.** It is quite interesting to note that a valid contract arises even if the letter of acceptance is lost in transit or is delayed. You should remember that the offerer will be bound by the acceptance only when the letter of acceptance was correctly addressed, properly stamped and actually posted. Thus, if the acceptance letter is not correctly addressed, it will not be binding upon the offerer.

From the above rules, it must be amply clear that so far as the acceptor is concerned, he is not bound by acceptance till it reaches the offerer. You must have noted that there is a time gap between the two dates, the date on which the letter of acceptance is posted and the date on which the offerer actually receives it. This time gap can be utilised by the acceptor to withdraw his acceptance by a speedier means of communication.

In the above example if B of Hydrabad sends his acceptance by post on April 10 the communication of acceptance is complete against A on April 10 i.e., when the letter of acceptance is posted, but the communication of acceptance shall be complete as against B only when this letter reaches A. Suppose A receives the letter of acceptance on April 12, at 11 a.m. then B will be bound by his acceptance on April 12 only. In other words, the law has given a chance to the acceptor to withdraw his acceptance.

2.4.3 Contracts over Telephone/Mobile

A contract by telephone or mobile is treated on the same principle as an oral agreement made between two parties when they are face to face with each other. Thus, when offers of acceptance are made on phone, the parties are in direct contact and no contract is concluded until the offerer actually receives or hears the acceptance i.e., the contract is made only when the acceptance, is clearly heard and understood by the offerer. The acceptor must ensure that his acceptance is properly received by the offerer. Normally when the parties disconnect they usually utter such words as 'Bye', 'O.K.', etc. This indicates that the parties have heard what they wanted to communicate. But, if the conversation is interrupted before acceptance has been given, the contract is not concluded. For example, A made an offer to B over telephone. While B was conveying his acceptance, the line suddenly went dead and A could not hear anything. Thus, no contract was concluded. Then, B makes another attempt and this time he could convey his acceptance. The contract is said to be concluded on the second attempt.

2.5 REVOCATION OF OFFER AND ACCEPTANCE

The term 'revocation' simply means 'taking back' or 'withdrawing'. Both offer and acceptance can be revoked or withdrawn. But, it is possible only upto a certain stage. Let us now study the rules regarding the revocation of offer and acceptance.

2.5.1 Revocation of Offer

According to Section 5 of the Contract Act "a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, but not afterwards." You know that communication of acceptance is complete as against the offerer when it is put in a course of transmission so as to be out of his power. **Hence, an offer can be revoked at any time before the letter of acceptance has been posted.** For example, A offers by letter to sell his car to B at a certain price. A may revoke his offer at any time before B posts his letter of acceptance, but not afterwards. Once the letter of acceptance has been posted, the offer cannot be revoked. Therefore, when the offerer wishes to revoke his offer, he must do so by a speedier mode of communication so that the revocation notice reaches the offeree before he posts his letter of acceptance.

Revocation must always be expressed and move from the offerer himself or a duly authorised agent. Notice of revocation of a 'general offer' must be given through the same channel by which the original offer was made.

2.5.2 Revocation of Acceptance

Section 5 of the Contract Act further provides that '*an acceptance may be revoked at any time before the communication of the acceptance is complete as against the acceptor, but not afterwards.*' You have already learnt that the communication of acceptance is complete as against the acceptor when it comes to the knowledge of the offerer. **Hence, the acceptor can revoke his acceptance at any time before his letter accepting the offer reaches the offerer**. Once the letter of acceptance reaches the offerer, the acceptance cannot be revoked. Thus, for effective revocation of acceptance it is necessary that the acceptor should adopt some speedier mode of communication so that his revocation reaches the offerer before the letter of acceptance. For example, A offers by a letter dated February 2, sent by post, to sell his house to B at a certain price. B accepts the offer on February 6 by a letter sent by post. The letter reaches A on February 8 at 2 p.m. Here B may revoke his acceptance at any time before 2 p.m. on February 8, but not afterwards.

When the parties at distant places communicate over telephone or e-mail, the question of revocation does not arise because there is instantaneous communication of the offer and its acceptance. The offer is made and accepted at the same time.

In brief you should remember that an offer can be revoked at any time before the letter of acceptance is posted and an acceptance can be revoked before it reaches the offerer.

2.5.3 Communication of Revocation

The communication of revocation is complete at different times for the person who makes it and the person to whom it is made. According to Section 4 the communication of revocation 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.**

Example: A proposes by letter to sell his house to B at a certain price. B accepts the proposal by a letter sent by post. If A revokes his offer by speed post, then revocation of offer is complete as against A, when the speed post is sent and for B it is complete when B receives the speed post. If B revokes his acceptance by speed post the revocation of acceptance is complete for B when the speed post is sent and as against A, when it reaches him.

2.6 LAPSE OF AN OFFER

You have learnt that the acceptance must be given before the offer lapses or is revoked. Now the question arises as to how long an offer remains open or up to what time it can be accepted. You must know this because the offer must be accepted before it lapses. Once an offer lapses it cannot be accepted. Let us now discuss the circumstances leading to lapse. They are as follows:

1) **By lapse of stipulated or reasonable time**: The offeree must accept the offer within the time prescribed in the offer and if no time is prescribed, it must be accepted within a reasonable time. Thus, the offer lapses if it is not accepted within the time prescribed in the offer or within a reasonable time. What is a reasonable time depends upon the circumstances in each case. In the case of **Ramsgate Victoria Hotel Co. v. Montefiore**, M offered to buy shares of a company on June 8. The Company informed him about the allotment on November 23. M refused to accept the shares. It was held that M's offer to buy shares had lapsed because it was not accepted within a reasonable time.

2) **By death or insanity of the offerer or the offeree before acceptance**: An offer lapses by the death or insanity of an offerer if the fact of his death or insanity comes to the knowledge of the acceptor before he makes his acceptance. But if the offer is accepted in ignorance of the death or insanity of the offerer, there will be a valid contract. This means that the death or insanity of the offerer does not terminate the offer automatically. The offer lapses only when this fact comes to the knowledge of the offeree before acceptance. **Our law is different in this respect from English law where the death of the offerer terminates the offer even if acceptance is made in ignorance of the death**.

   There is no provision in the Act about the effect of the death of an offeree before acceptance. But it is an established rule that the offer comes to an end on the death of the offeree, because an offer can be accepted only by the offeree and not by any other person. It cannot be accepted by the legal heirs of the offeree.

3) **By failure to fulfil condition precedent to acceptance**: When there is a condition in the offer which must be fulfilled before the acceptance of the offer, the offer lapses if the acceptance is given without fulfilling that condition. For example, A offered to sell his scooter to B for Rs. 10,000 subject to

the condition that B should pay Rs. 2,000 before a certain date. B accepted the offer but did not pay the money. In this case the acceptance has no validity and the offer stands terminated.

4) **By rejection of offer by the offeree**: An offer lapses as soon as it is rejected by the offeree. Once an offer is rejected, it cannot be revived subsequently. An offer is said to be rejected, if the offeree expressly rejects it or accepts it subject to certain conditions.

5) **If it is not accepted in the prescribed or usual mode**: Sometimes, the offerer prescribes the mode of acceptance. In such a situation the offer must, be accepted in that very manner and if it is not accepted in the prescribed mode the offer stands lapsed. For example, A offers to sell his house to B and writes to B send your acceptance by e-mail. Now if the acceptance is sent by some other mode, then A may not be bound by the acceptance. You have learnt about it in detail in Sub-section 2.3.4 of this unit.

6) **By counter offer by the offeree**: Counter offer means making a fresh offer instead of accepting the original offer. A counter offer amounts to the rejection of the original offer. Hence, as soon as the counter offer is made, the original offer stand lapsed. If the person who makes a counter offer changes his mind and wishes to accept the original offer, he cannot do so. For example, A offered to sell his bicycle to B for Rs. 500. B said that he would buy it for Rs. 200. Here B's offer to buy for Rs. 200 is counter offer and terminates the original offer of A. If later on B wants to buy the cycle for Rs. 500, it will be a case of a fresh offer and not an acceptance of the original offer.

7) **By revocation**: If the offerer revokes the offer before its acceptance by the offeree, the offer stands lapsed. According to rules, an offer can be revoked, at any time before it is accepted by communicating a notice of revocation to the offeree. For example, at an auction sale, the highest bidder can revoke his offer to buy before the fall of the hammer.

8) **By subsequent illegality or destruction of subject-matter**: An offer lapses if it becomes illegal before it is accepted. For example, A of Delhi offered to supply 100 bags of rice to B at Lucknow on a certain date. But, before this offer is accepted by B, the Government has issued an order prohibiting the inter-state movement of foodgrains. Automatically the offer made by A comes to an end. Similarly, if the subject-matter of the offer is destroyed before acceptance, the offer lapses.

Check Your Progress C

1) When is communication of offer complete?

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2) When is communication of acceptance complete as against the acceptor?

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....

....

3) When is communication of revocation complete?

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....

....

4) Fill in the blanks :

   i) Communication of offer is complete when ....

   ii) Communication of acceptance is complete as against the offerer when ………………………………………………………....

   iii) An offer can be revoked at any time ....

   iv) An acceptance can be revoked at any time ....

   v) An offer will .... if it is rejected by the offeree.

5) State whether the following statements are True or False:

   i) An acceptance once given cannot be revoked. ....

   ii) The communication of acceptance is complete as against the acceptor when it is put into a course of transmission...................

   iii) An offer can be revoked at any time before its acceptance is complete as against the offerer. ....

   iv) A letter of acceptance sufficiently stamped and duly addressed is posted, a valid contract arises.....................................

   v) Counter offer amounts to rejection of the original offer. ....

2.7 LET US SUM UP

For a contract to be valid there must be a definite offer by one party and its unconditional acceptance by the other. When a person signifies his readiness to do or to abstain from doing something with a view to obtain the consent of the other party, he is said to have made an offer (also called proposal). This offer may be made to a specific person (specific offer) or to the world at large (general offer). An offer may be made expressly by words, spoken or written, or it may be implied when it is inferred from the conduct of the parties or circumstances of the case.

An offer to be valid (i) it must intend to create legal relations, (ii) the terms of offer must be certain and unambiguous, (iii) it must be distinguished from a mere declaration of intention, (iv) it must be distinguished from an invitation to offer, (v) it must be communicated, (vi) it must not contain a term the non-compliance of which would amount to acceptance, and (vii) special terms of the offer must also be communicated along with the offer.

Similar offers made by two parties to each other, in ignorance of each other's offer, are known as 'cross offers'. Cross offers do not amount to acceptance. An offer of a continuous nature (tender) is known as 'standing offer'. It is the same thing as an invitation to an offer. A contract arises only when an order is placed on the basis of the tender.

When the person to whom an offer is made gives his consent thereto, the offer is said to have been accepted. It has the effect of converting the offer into a promise. An offer can be accepted only by the person to whom it is made. Acceptance may be express or implied.

An acceptance to be valid it (i) must be absolute and unqualified, (ii) must be in the prescribed manner, (iii) must be communicated, (iv) must be communicated by an authorised person, (v) must be given within the time prescribed or with in a reasonable time, and (vi) must be given before the offer lapses.

The communication of offer is complete when it comes to the knowledge of the person to whom it is made. The communication of acceptance is complete (i) as against the offerer, when it is put in a course of transmission to him so as to be out of the power of the acceptor, and (ii) as against the acceptor, when it comes to the knowledge of the offerer.

An offer may be revoked up to the time the acceptor posts his letter of acceptance but not afterwards. An acceptance may be revoked at any time before the letter of acceptance reaches the offerer, but not afterwards. The communication of revocation 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, and (ii) as against the person to whom it is made, when it comes to his knowledge.

An offer comes to an end (i) by lapse of stipulated or reasonable time, (ii) by the death of insanity of the offerer or the offeree before acceptance, (iii) by the failure to fulfil a condition precedent to acceptance (iv) by rejection of offer by the offeree, (v) when it is not accepted in the prescribed manner or in some usual or reasonable manner, (vi) when a counter offer is made by the offeree, (vii) when the offerer revokes the offer-before it is accepted by the offeree, (viii) when it becomes illegal or its subject-matter is destroyed before acceptance.

2.8 KEY WORDS

Acceptance: Giving consent to the offer.

Counter Offer: A conditional acceptance or a fresh offer instead of accepting the original offer.

Cross Offer: Similar offers made by two parties to each other without knowing about the offer made by the other party. It does not amount to acceptance.

Express Offer: An offer made expressly by words spoken or written.

General Offer: Offer made to the world at large.

Implied Offer: An offer inferred from the conduct of the party or the circumstances of the case.

Invitation to Offer: Offer invited from others by giving an ad, quotations, or price lists, etc.

Offer: Expression of a proposal to do or its abstaining from doing something with a view to obtain the consent of the offeree.

Revocation: Taking back or cancelling an offer or the acceptance.

Specific Offer: Offer made to a definite person.

Standing Offer: A continuous offer in the form a tender.

2.9 ANSWERS TO CHECK YOUR PROGRESS

A) 4) i) express, ii) certain, iii) offer, iv) the person to whom it is made, v) not binding

5) i) False, ii) False, iii) True, iv) False, v) False, vi) False.

B) 3) i) unqualified, ii) the person to whom it is made, iii) prescribed, iv) offer lapses, v) rejected.

4) i) False, ii) False, iii) True, iv) True, v) False.

C) 4) i) when it comes to the knowledge of the person to whom it is made.

ii) when the letter of acceptance is posted.

iii) before its acceptance is complete as against the offerer.

iv) before the letter of acceptance reaches the offerer.

v) lapse.

5) i) False, ii) False, iii) True, i) True, v) True.

2.10 TERMINAL QUESTIONS/EXERCISES

1) Define the term "proposal". Discuss the essentials of a valid offer.

2) What is acceptance? How can an offer be accepted? Who can accept an offer?

3) Comment on the following statements.

   i) "An invitation to offer is not an offer."

   ii) "Acceptance must be something more than a mere mental assent."

   iii) "There cannot be a contract to make a contract".

4) When does an offer come to an end?

5) Explain briefly the law relating to communication of offer, acceptance and revocation. Is there any limit of time after which an offer cannot be revoked?

6) Can the following be regarded as offers?

   i) a catalogue of goods for sale

   ii) an advertisement to sell goods by auction

   iii) display of goods with price tags attached to them

   iv) an advertisement by a company for subscribing to its shares

   v) an announcement or notice to pay a reward of Rs. 1,000 to anyone who finds and returns his lost dog.

7) Explain the following terms with examples

   i) Cross Offer

   ii) Counter Offer

   iii) General Offer

iv) Implied Offer

v) Invitation to Offer

8) Answer the following giving suitable reasons.

i) Narender offers to sell his scooter to Mohan for Rs. 16,000. Mohan replies, “I will pay Rs. 12,000 for it.” Narender refuses to sell at this price. Mohan then offers to pay Rs. 16,000 to Narender. But, Narender refuses to sell his scooter. Discuss the position of parties.

(*Hint*: Narender is not bound to sell his scooter. His original offer to sell for Rs. 16,000 came to an end when a counter offer was made.)

ii) Ram offered to pay Rs 50,000 to any person who would swim a hundred yards on Bombay’s sea coaston the New Year’s Day. A fisherman was accidently thrown overboard by the rough sea waves and he swam this distance to save his life. He claimed this award. Will he succeed?

(*Hint*: No, the fisherman cannot claim the money because he swam the distance without knowing about the offer.)

iii) A sends a proposal to B by post. B dies before accepting the proposal. B’s legal representative accepts the proposal. Is this acceptance valid?

(*Hint*: No, his acceptance is not binding on A because this is a specific offer to B and he alone can accept it.)

iv) A proposes, by a letter sent by post to sell his car to B at a certain price. B accepts the proposal by a letter sent by post. B sends a e-mail next day revoking his acceptance and thise-mail received by A before the letter of acceptance. Is revocation of acceptance valid?

(*Hint*: Yes, B’s revocation is valid because the acceptor can revoke at any time before the letter of acceptance reaches the offerer.)

v) Vijay gave an advertisement in the newspapers that he would sell his household goods by auction on January 10, 2019 at his residence at New Delhi. Ajit from Bombay, reach New Delhi on the appointed date and time, but Vijay had cancelled the auction sale. Advise Ajit.

(*Hint*: It was not an offer but only an invitation to offer. Hence, Amitabh cannot take any action against Vijay.)

vi) Lalji offered to sell his plot to Sohan for Rs. 50 lakh Sohan accepts the offer enclosing a cheque for Rs. 20 lakh. With a promise to pay the balance in two instalments. Is there any contract?

(*Hint*: No this is a conditional acceptance.)

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

UNIT 3 CAPACITY OF PARTIES

Structure

3.0 Objectives

3.1 Introduction

3.2 Who is Competent to Contract?

3.3 Position of a Minor

3.3.1 Who is a Minor?

3.3.2 Position of Agreements by a Minor

3.4 Agreements by Persons of Unsound Mind

3.4.1 Who is a Person of Sound Mind?

3.4.2 Burden of Proof

3.4.3 Position of Agreements with Persons of Unsound Mind

3.5 Persons Disqualified by Law

3.6 Let Us Sum Up

3.7 Key Words

3.8 Answers to Check Your Progress

3.9 Terminal Questions/Exercises

ignou THE PEOPLE'S UNIVERSITY

3.0 OBJECTIVES

After studying this unit, you should be able to:

- explain who is competent to contract;
- explain who is a minor and describe the position of agreements with the minors;
- identify persons of unsound mind and explain the position of agreements with such persons; and
- identify persons disqualified under other laws and describe their position in relation to contract.

3.1 INTRODUCTION

You learnt in Unit 1 that the parties to a contract must be competent to contract. If any one of them is incompetent to contract, the agreement shall be void, i.e., it cannot be enforced by law. In this unit, you will learn as to who are competent to contract and what shall be the exact position of a contract in case any one of the parties thereto is incompetent of contracting.

3.2 WHO IS COMPETENT TO CONTRACT?

Section 10 of the Indian Contract Act requires that parties must be competent to contract. Section 11 of the Indian Contract Act clearly states as to who shall be competent to contract. It provides that *every person is competent to contract*

(i) who is of the age of majority according to the law to which he is subject, (ii) who is of sound mind, and (iii) who is not disqualified from contracting by any law to which he is subject. Thus, a person to be competent to contract should not be

i) a minor, or ii) of an unsound mind, or iii) disqualified from contracting

Let us now consider each of the aforesaid elements of competency to contract.

3.3 POSITION OF A MINOR

3.3.1 Who is a Minor?

According to Section 3 of the Indian Majority Act, a person is deemed to have attained majority (i) when he completes 18 years or (ii) where a guardian of person or property or both has been appointed by a Court of Law (or where his property has passed under the superintendence of the Court of Wards), he attains majority on completion of 21 years. In other words, normally a person shall be treated as minor if he has not attained the age of 18 years. In the following two cases, however, he is treated as minor until he attains the age of 21 years.

i) where a guardian of a minor's person or property is appointed under the guardians and Wards Act, 1890, or

ii) where the superintendence of minor's property is assumed by a Court of Wards.

3.3.2 Position of Agreements by a Minor

According to Section 11, as stated earlier, no person is competent to contract who is not of the age of majority. In other words, a minor is not competent to contract. In fact, the law acts as the guardian of minors and protects their rights because they are not mature and may not possess the capacity to judge what is good and what is bad for them. Hence the minor is not bound by any promises made by him under an agreement.

The position with regard to minor's contracts may be explained as follows:

1) **A contract with or by a minor is absolutely void and the minor therefore cannot bind himself by a contract**: The case of **Mohiri Bibiee v. Dharmodas Ghosh** is a case in point. The Privy Council in this case held that a minor's agreement is altogether void. It is void *ab-initio* i.e. from the very begining. The facts of the case were: Dharmodas a minor, entered into a contract for borrowing a sum of Rs. 20,000. The lender advanced Rs. 8,000 to him and Dharmodas executed a mortgage of his property in favour of the lender. Subsequently, the minor sued for setting aside the mortgage. The Privy Council held that sections 10 and 11 of the Indian Contract Act make the minor's contract void and therefore the mortgage was not valid. Then, the mortgagee, prayed for refund of Rs. 8,000 by the minor. The privy council further held that as a minor's contract was void, any money advanced to him could not be recovered.

2) **Fraudulent representation by a minor**: Will it make any change in case minor is guilty of deliberate misrepresentation about his age thereby inducing the other party to contract with him? No! it will make no change in the status of the agreement. The contract shall continue to remain void because if such a thing is permitted, unscrupulous people while dealing with a minor shall, as

a first thing, ask him to sign a declaration that he is of the age of majority. It will thus defeat the whole objective of protecting his interests.

In the case **Leslie v. Sheill** S, a minor by fraudulently representing himself to be a major, induced L to lend him £ 400. He refused to repay it and L sued him for the money. Held, that the contract was void and S was not liable to repay the amount due.

The same decision was endorsed in the case of **Kanhya Lal v. Girdhari Lal** and the minor was not held liable on the promissory note executed by him.

A minor can always plead that he is a minor. The doctrine of estoppel which is an important principle of the Law of Evidence does not apply on a minor, i.e., he cannot be estopped from denying his majority.

But, should it mean that those younger in age have liberty to cheat the seniors and retain the benefits. The minors are not allowed to cheat. The Lahore High Court (prior to partition) in **Khan Gul v. Lakha Singh** held that where the contract is set aside the *status quo ante* should be restored and the court may direct the minor, on equitable grounds, to restore the money or property to the other party. This is called of restitution. Thus, in such cases, if money could be traced, the court would, on equitable grounds, ask the minor for restitution. Sections 30 and 33 of the Specific Relief Act, 1963 provide that in 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.

3) **Ratification of a contract by a minor on attaining the age of majority**: A minor's agreement is void *ab-initio*. Hence, there can be no question of its being ratified even after he attains majority. In **Indran Ramaswamy v. Anthappa** a person gave a promissory note in satisfaction of one executed by him for money borrowed when he was a minor. The Court held that the claim thereunder could not be enforced because there was no fresh consideration. Consideration given during minority is not a good consideration. However, where a person on attaining majority actually pays the debt incurred by him during minority, it is treated as valid. In law it is to be regarded on the same footing as a gift (**Anant Rai v. Bhagwan Rai**). You should note that an agreement with a minor is merely void and not unlawful, so the sum paid cannot be sued for subsequently.

4) **Minor's contract jointly with a major person**: Documents jointly executed by a minor and an adult major person would be void vis-a-vis the minor. But they can be enforced against the major person who has jointly executed the same provided there is a joint promise to pay by such a major person (**Jumna Bai v.Vasanta Rao**).

5) **Minor as a partner**: 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, be admitted to the benefits of partnership (Section 30 of the Partnership Act, 1932). This means he can share the profits without incurring any personal liability for losses.

6) **Minor as an agent**: A minor can act as an agent and bind his principal by his acts without incurring any personal liability.

7) **Minor as a shareholder**: There has been a strong controversy as to whether a minor can become a shareholder/member of a company. In view of the provisions of the Indian Contract Act and the Privy Council's decision, a minor cannot become a member of the company (**Palaniapa v. Pasupati Bank**). Thus, if a minor acquires partly paid shares the company will not be able to recover the uncalled amount from the minor. However, there are contrary decisions wherein it has been held that a minor can become a subscriber to the memorandum of association and can acquire shares by allotment. In **Laxon Co.'s case**, it was held that a minor can be a shareholder unless the articles of association of the company prohibit it. In **Dewan Singh v. Minerva Films Ltd.**, the Punjab High Court held that there was no legal bar to a minor becoming a member of a company by acquiring shares (i.e., by way of transfer) provided the shares were fully paid up and no further obligation or liability was attached to them. It may thus be concluded that a minor can become a shareholder/ member of a company provided that the shares held by him are fully paid shares and the articles of association do not prohibit it.

8) **A minor cannot be declared insolvent because he is incapable of contracting debts.**

Exceptions

1) **Contract for the benefit of a minor:** A person incompetent to contract may accept a benefit and be a transferee. Although a sale or mortgage of property by a minor is void, a duly executed transfer by way of sale or mortgage in favour of a minor who has paid to valid consideration is not void. Such a transaction shall be enforceable by him or any other person on his behalf, A minor, therefore, in whose favour a deed of sale is executed is competent to sue for possession of the property conveyed thereby. It was held by a Full Bench of the Madras High Court that a mortgage executed in favour of a minor who has advanced the mortgage money is enforceable by him or by any other person on his behalf (**Raghva v. Srinivasa, 1917**). Similar, a minor can be the payee of a cheque or any other negotiable instrument and claim payment thereon. Also, where a minor sells goods to another major person, he shall be entitled to recover its price from him.

2) **Contract by Guardian:** A contract may be entered into on behalf of a minor by his guardian or manager of his estate. In such a case the contract can be enforced by or against the minor provided that the contract (a) is within the scope of the authority of the guardian or manager, and (b) is for the benefit of the minor (**Subramanyam v. Subba Rao**). Thus, a contract entered into by a parent or certified guardian of a minor for the sale of property belonging to the minor can be enforced by either party since it may be for the minor's benefit. However, all contracts made by a guardian on behalf of a minor are not valid. For instance, the guardian of a minor has no power to bind the minor by a contract for the purchase of immovable property (**Bholanath v. Balbhadra Prasad**). Similarly, a guardian of a minor cannot enter into a valid contract of service on his/her behalf (**Raj Rani v. Prem Adib**).

3) **Contract for Supply of Necessaries**: A contract for supply of necessaries to a minor or to those who are dependent on him can be enforced against him, not personally, but so far as his property may extend. Section 68 in this regard reads as follows:

If a person, incapable of entering into a contract, or anyone whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.

It may not be possible to draw an exhaustive list as to what shall constitute 'necessaries'. In fact, what may be 'necessaries' for one, may be a luxury for another. Buttons, for example, are a normal part of clothing and may therefore be treated as 'necessaries', but not the gold or diamond buttons (a prince may be an exception). 'Necessaries' must, therefore, be understood in relation to the social status of the person concerned. 'Necessaries' normally include articles required to maintain a particular person in the state, degree and status in life in which he is. The English Sale of Goods Act defines necessaries as goods suitable to the condition in life of the minor, and to his actual requirements at the time of sale and delivery (Section 2). Thus, an item will not be treated as necessaries if a person is already sufficiently supplied with things of that kind. It is immaterial whether the other party knows this or not. In the case of **Nash v. Inman** a minor who was a B. Com. student, bought eleven fancy coats from N. He was, at that time, adequately provided with clothes. **Held**, not even a single coat, was a necessity. His properties could not, therefore, be attached for its payment. In India, besides food, clothing and shelter, the education and marriage of a female have also been held to be necessaries. Any supply of such items or loans for the same shall, therefore, qualify for claim under Section 68.

However, you should note that the payment for necessaries supplied to a minor can only be claimed out of the properties belonging to the minor. He cannot be held personally liable for the same, i.e., he cannot be asked to expend labour in exchange, nor can his income, if any, be attached. This rule is equally applicable to the necessary services rendered to him. Thus, 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.

It should also be noted that the parent or guardian of a minor cannot be held liable unless those goods are supplied (or services rendered) to a minor as the agent of the parent or guardian, that is, the minor has collected them on behalf of his parent or guardian.

Check Your Progress A

1) Who is a minor?

....

....

....

2) State whether the following statements are True or False.

   i) A contract with a minor is voidable at the option of the minor ....

   ii) A contract with a minor is void-ab-initio ....

   iii) A contract with a minor cannot be enforced by a minor even for his benefit. ....

   iv) A minor cannot recover the price of his goods sold on credit to a major person. ....

   v) A minor can be the payee of a cheque ....

   vi) A minor cannot be appointed as an agent. ....

   vii) A partnership firm may be created by or with a minor as a partner ....

   viii) A minor may ratify his contract after attaining majority. ....

   ix) A minor is personally liable for the necessaries supplied to him or his dependents. ....;......................................

   x) Guardian of a minor shall not be held liable for necessaries supplied to his dependent children. ....

3) The guardian of a minor: (a) can or (b) cannot bind the minor by a contract for the purchase of immovable property. Which statement is correct? Give reason.

   ....

   ....

   ....

4) A minor wanted to become a professional billiards player and entered into an agreement with a famous billiards player. Under the contract, the minor would pay a certain sum of money of the billiards player to learn the game and would also accompany the man to play matches during the world tours. Is the agreement valid?

   ....

   ....

   ....

5) A, a minor and an undergraduate student of a university, buys on credit from B, a clothier, seven suit lengths for his own use. Is B entitled to any payment in respect of the goods?

   ....

   ....

   ....

3.4 AGREEMENTS BY PERSONS OF UNSOUND MIND

3.4.1 Who is a Person of Sound Mind?

You know that a person while making a contract should be of a sound mind otherwise the contract will have no validity in the eyes of law. Who is a person of sound mind has been amply clarified by Section 12 of the Indian Contract Act which reads *"a person is said to be of sound mind for the purpose of making a contract, if at the time when he makes it, he is capable of understanding it and of forming a rational judgement as to its effect upon his interests."* Thus soundness of mind 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. Section 12 further states that *a person who is usually of unsound mind. but occasionally of sound mind, may make a contract when he is of sound mind. A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.*

Examples

1) A patient in a lunatic asylum, who is at intervals of sound mind may contract during those intervals.

2) A sane man, 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 interest, cannot contract whilst such delirium or drunkenness lasts.

Whether a party to a contract, at the time of entering into the contract, is of sound mind or not is a question of fact to be decided by the court.

3.4.2 Burden of Proof

The following rules may be noted in this regard:

1) Where a person is usually of sound mind, the burden of proving that he was of unsound mind at the time of execution of a document lies on the person who challenges the validity of the contract **(Trilok Chand v. Mahandu)**.

2) Where a person is usually of unsound mind, the burden of proving that at the time he was of sound mind lies on the person who affirms it.

3) In cases of drunkenness or delirium from fever or other causes, the onus lies on the party who sets up that disability to prove that it existed at the time of the contract.

3.4.3 Position of Agreements by Persons of Unsound Mind

1) **Lunatics:** A lunatic is a person who is mentally deranged due to some mental strain or other personal experience. However, he has some intervals of sound mind. He is not liable for contracts entered into while he is of unsound mind. However, as regards contracts entered into during lucid

intervals, he is bound. His position in this regard is identical with that of a minor.

2) **Idiots**: An idiot is a person who is permanently of unsound mind. Idiocy is a congenital defect. Such a person has no lucid intervals. He cannot make a valid contract. In **Inder Singh v. Parmeshwardhari Singh** a property worth about Rs.25,000 was agreed to be sold by a person for Rs. 7,000 only. His mother proved that he was a congenital idiot, incapable of understanding the transaction. Holding the sale to be void, Justice Sinha of Patna High Court stated that "it is not necessary that a man must be suffering from lunacy to disable him from entering into a contract. A person may, to all appearances, behave in a normal fashion but at the same time, he may be incapable of forming a judgement of his own as to whether the act he is about to do is in his interest or not. In the present case he was incapable of exercising his own judgement".

3) **Drunken or intoxicated Persons**: Drunkenness is on the same footing as lunacy. A contract by drunken person is altogether void. It should be noted that partial or ordinary drunkenness is not sufficient to avoid a contract. It must be clearly shown that, at the time of contracting, the person pleading drunkenness was so intoxicated as to be temporarily deprived of reason and was not in a position to give valid consent to the contract. Illustration (b) to Section 12 of the Indian Contract Act reads: *A sane man 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 effects on his interest cannot contract while such delirium or drunkenness lasts.*

Exceptions

A contract with a person of unsound mind is subject to the same exceptions as the contract with a minor is. Thus a person of unsound mind (i) may enforce a contract for his benefit, and (ii) his properties, if any, shall be attachable for realisation of money due against him for supply of necessaries to him or to any of his dependents.

3.5 PERSONS DISQUALIFIED BY LAW

Besides minors and persons of unsound mind, there are some other persons who have been declared incompetent of contracting, partially or wholly, so the contracts of such persons are void. Incompetency to contract may arise from political status, corporate status, legal status, etc. This has been explained as follows :

Alien Enemy: An alien is a person who is the citizen of a foreign country. Thus, in the Indian context an alien may be (i) an alien friend, or (ii) an alien enemy.

Contracts with an alien friend, (i.e., a foreigner) whose country is at peace with the Republic of India are valid subject to certain resrictions. But, he cannot acquire property in Indian ship or be employed as Master or any of other Chief Officer of such a ship.

In the case of contracts with an alien enemy (i.e., an alien whose country is at war with Republic of India) the position may be studied under two heads: (i) contracts during the war and (ii) contracts made before the war. During the subsistence of the war, an alien can neither contract with an Indian subject nor can be sued in an Indian Court except by licence from the Central Government. As regards

contracts entered into before the war breaks out, they are either dissolved or merely suspended. All contracts, which are against the public policy or are such that may benefit the enemy, stand dissolved. The contracts which are not against public policy are merely suspended for the duration of the war and revived after the war is over, provided they have not already become time-barred under the law of limitations.

It may be observed that an Indian, who resides voluntarily or who is carrying on business in a hostile territory will be treated as an alien enemy.

Foreign Sovereigns and Ambassadors: Foreign sovereigns and accredited representatives of a foreign state (Ambassadors) enjoy some special privileges. They cannot be sued in our courts unless they choose to submit themselves to the jurisdictions of our courts. They can enter into contracts and enforce those contracts in our courts, but they cannot be proceeded against in Indian Courts without the sanction of the Central Government.

The aforesaid immunity of a sovereign continues even if he engages in trade. But, an ex-king is not entitled to this and can thus be sued against in our courts. If, however, a foreign sovereign, etc. enter into a contract through an agent residing in India, the agent shall be held liable on the contract.

Convicts: A convict is not competent to contract during the continuance of sentence of imprisonment. This inability comes to an end with the expiration of the period of sentence. A convict can, however, enter into, or sue on, a contract when on parole or when he has been pardoned by the court.

Company under the Companies Act or Statutory Corporation under special Act of Parliament: A company or a corporation is an artificial person. It exists only in contemplation of law, its contractual capacity, is determined by its constitution. The contractual capacity of a statutory corporation is expressly defined by the statute creating it. The contractual capacity of a company registered under the Companies Act is determined by the objects clause of its memorandum of association. Any act done in excess of the powers given in the memorandum is ultra-vires and void. However company or corporation is not allowed to enter into contract of personal nature.

Insolvents: When a debtor is adjudged insolvent, his property stands vested in the Official Receiver or Official Assignee appointed by the Court. He cannot enter into contracts relating to his property and sue, and be sued, on his behalf. **This disqualification of an insolvent is removed after he is discharged.**

Check Your Progress B

1) State whether the following statements are True or False.

   i) A person who is usually of an unsound mind cannot enter into a contract even when he is of a sound mind...

   ii) An idiot cannot make a contract but a lunatic can. ....

   iii) A person of sound mind can make a valid contract even when he is so drunk that he is incapable of forming a rational judgement. ....

   iv) An alien friend can acquire property in Indian ship. ....

v) A company, though an artificial person, can make all such contracts that an individual can. ....

2) Whom do you regard as a person of sound mind?

....

....

....

3) What is idiocy?

....

....

....

3.6 LET US SUM UP

The parties to a contract must be competent to contract, otherwise the contract will not be valid. A person is competent to contract if he (i) is of the age of majority (ii) is of a sound mind, and (iii) has not been disqualified from contracting by any law to which he is subject.

A person is deemed to have attained majority when he completes 18 years (it is 21 years in some cases). Any person who has not attained the age of majority is called a minor and the contract with him is regarded void ab-initio. Not only that, an agreement with a minor cannot be ratified even after he attains majority. He cannot become a partner in a firm but can be admitted to the benefits of the firm. He can, however, become a shareholder in a company provided the shares held by him are fully paid up and the articles of association do not prohibit it. He can also be a promisee or beneficiary. His guardians can act on his behalf within certain limits. His property can be used for the payment of price of the necessaries supplied to him or his dependents.

A person is said to be of a sound mind if, at the time of contracting, he is capable of understanding the terms of the contract and of forming a rational judgement as to its effects upon his interests. An idiot, a lunatic and a drunken person are usually regarded as persons of an unsound mind. The position of contracts with persons of unsound mind is similar to that of a contract with a minor.

Besides minors and persons of unsound mind, there are others who are disqualified from contracting under the provisions of some other laws. Such persons are: (i) alien enemies (ii) foreign sovereigns, (iii) convicts, and (iv) insolvents. However, though a foreign sovereign or dignitary cannot be sued in our courts for claiming the performance of a contract, he can sue in our courts and claim its performance.

3.7 KEY WORDS

Alien: A resident of a foreign country.

Convict: A person found guilty of an offence.

Idiot: A person so mentally deficient by birth as to be incapable of ordinary reasoning or rational conduct.

Lunatic: A person affected by lunacy or of an unsound mind. A person can become lunatic at any stage of his life.

Minor: A person who has not attained the age of 18 years (21 years in some situations).

Necessaries: Items necessary for living suitable to the condition in life of an individual and to his actual requirement at the time of sale and delivery.

3.8 ANSWERS TO CHECK YOUR PROGRESS

A) 2) i) false ii) true iii) false iv) false v) true vi) true vii) false viii) false ix) false x) true

3 The statement (b) is correct. (Sarwarajan, v. Fakhrudin Mohammed)

4) Yes, Education is regarded as a necessity. (Roberts v. Gray)

5) No, seven coats at a time cannot be a necessity. (Nash v. Inman)

B) 1) i) false ii) true (a lunatic can enter into a contract during lucid intervals) iii) false iv) false v) true (with the exception of contracts of personal nature e.g., a contract to marry) .

3.9 TERMINAL QUESTIONS/EXERCISES

1) Who is competent to contract? State the position of contracts with a minor.

2) What shall be the effect on a contract where a minor, a party to the contract, is guilty of deliberate misrepresentation with regard to his age?

3) What are necessaries? When is a minor liable on a contract for necessaries?

4) Examine the legal position of (i) a minor as a promisee, (ii) a minor as an agent.

5) Who are treated as persons of unsound mind? State the legal positions of contracts with such persons.

6) Enumerate persons forbidden under other laws for the time being in force and state the legal position of the contracts with them.

7) Answer the following problems giving reasons for your answer.

   i) A minor was facing a criminal prosecution for dacoity. He borrowed Rs. 2,000 to defend himself. Will the creditor succeed in recovering the amount?

   (*Hint*: It is loan for necessaries. It can be recovered from Minor's property)

   ii) Hari sold some goods to Gaurav on credit not knowing that Gaurav was a minor. Hari did not receive the payment. Can he sue Gaurav on attaining majority?

   (*Hint*: No, a contract with a minor is void ab-initio)

   iii) A, a minor sold some goods to B, a major. Can he recover the price?

   (*Hint*: Yes, a minor can be a promisee)

v) Anthony, a major, executes a promissory note in favour of Robert for the necessaries supplied by Roberts to Anthony during Anthony's minority. Is Anthony liable to Roberts on the promissory note?

(*Hint*: No, Anthony is not liable to pay)

v) Shailendra, on behalf of her minor daughter, entered into a contract with Girish whereby Girish promised to marry her. Later on, Girish refused to marry. Can she sue Girish for damages?

(*Hint*: Yes, she could maintain a suit for damages as it was for her benefit.)

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

UNIT 4 FREE CONSENT

Structure

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4.0 OBJECTIVES

After studying this unit, you should be able to:

- explain the meaning of consent;
- describe the circumstances when consent is not free;

- explain the meaning of coercion and undue influence, and their effect on the validity of a contract;
- distinguish between coercion and undue influence;
- explain the meaning of misrepresentation and fraud, and describe their effect on the validity of a contract;
- distinguish between misrepresentation and fraud; and
- describe various types of mistakes and their effect on the validity of a contract.

4.1 INTRODUCTION

You have learnt that there are some essentials of a valid contract and one of them is that the consent of the contracting parties must be free. If the consent is not free, the contract shall be treated as void or voidable depending upon the factor which affected the consent. In this unit you will learn about the meaning of consent and free consent and the various factors that affect the consent viz., coercion, undue influence, fraud, misrepresentation, and mistake. You will also learn how far the validity of an agreement is affected by each of these factors.

4.2 MEANING OF CONSENT

You have learnt that when two parties enter into a contract they should give their consent. The consent of the parties means that they understand the same thing in the same sense. There must be no misunderstanding between the parties about the subject matter of the contract. Section 13 of the Indian Contract Act defines the term 'Consent' as *two or more persons are said to consent when they agree upon the same thing in the same sense.*

Thus, consent involves identity of minds in respect of the subject matter of the contract. In English Law, this is called '*consensus-ad-idem*'. If the parties are not having consensus-ad-idem on the subject matter of the contract, then there is no real agreement between them. When two persons enter into a contract concerning a particular person or a thing and it turns out that each of them had a different person or thing in mind, no contract would exist between them. For example, A has two Maruti cars, one is blue and the other is red. He wants to sell his red Maruti car. B who knows of only A's blue car, offers to buy A's car for Rs. 60,000. A accepts the offer thinking it to be an offer for his red Maruti car. Here the two parties are not thinking in terms of the same subject matter. Hence, there is no consent and the contract will not be valid. In **Foster v. Mackinnon**, the defendant has purported to endorse a bill of exchange which he was told was a guarantee. The court held that he was not liable as his mind did not go with that writing and he never intended to sign a bill of exchange. There was no consent and consequently no agreement arose.

4.3 CONCEPT OF FREE CONSENT

For a contract to be valid it is not enough that the parties have given their consent. The consent should also be free i.e., it has been given by the free will of the parties involving no pressure or use of force. Section 10 of the Contract Act specifically provides *that All agreements are contracts if they are made by the free consent of the parties* .... Now let us understand when the consent is said to be free.

Section 14 of the Act states that *Consent is said to be free when it is not caused by (i) coercion, or (ii) undue influence, or (iii) fraud, or (iv) misrepresentation, or (v) mistake*. Thus, the consent of the parties to a contract is regarded as free if it has not been induced by any of the five factors stated under Section 14. In other words, the consent is not free if it can be proved that it has been caused by coercion, undue influence, fraud, misrepresentation, or mistake, For example, X, at a gun point, makes Y agree to sell his house to X for Rs. 50,000. Here, Y's consent has been obtained by coercion and therefore, it shall not regarded as free.

When the consent of any party is not free, the contract is usually treated as voidable at the option of the party whose consent was not free. If, however, the consent has been caused by mistake on the part of both the parties, the contract is considered void. Look at Figure 4.1 it depicts the factors affecting free consent and their effect on the validity of the contract.

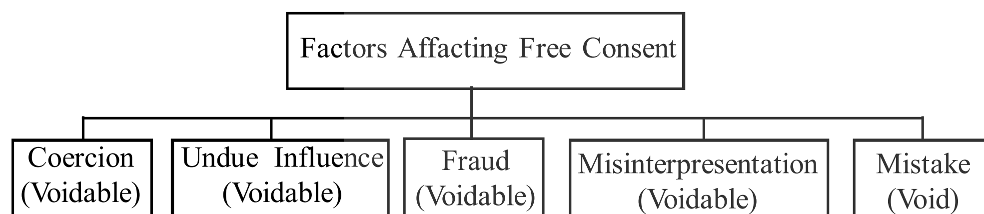

Fig. 4.1

You should note that there is a difference between, the two situations viz., (i) when there is no free consent, and (ii) when there is no consent at all. In case the consent is not free the contract is voidable, at the option of the party whose consent is not free. But in case there is complete absence of consent, the agreement is void ab-initio i.e., it is not enforceable at the option of either party. Let us now discuss each of these five factors affecting free consent in detail.

4.4 COERCION

4.4.1 What is Coercion?

Coercion means forcibly compelling a person to enter into a contract i.e., the consent of the party is obtained by use of force or under a threat. Section 15 of the Contract Act defines 'coercion' as *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.* In other words, the consent is said to be caused by coercion when it is obtained by exercising some pressure by either committing or threatening to commit any act forbidden by the Indian Penal Code or unlawfully detaining or threatening to detain any property. Coercion, thus, implies committing or threatening to commit some act which is contrary to law. Let us now analyse the implications of this definition.

1) **Committing any act forbidden by the Indian Penal Code**: When the consent of a person is obtained by committing any act which is forbidden by the Indian Penal Code, the consent is said to be obtained by coercion. Committing a murder, kidnapping, causing hurt, rape, defamation, theft etc. are some of the examples of the acts forbidden by the Indian Penal Code.

For example, A beats B and compels him to sell his scooter for Rs. 2,000. In this case the consent of B is induced by coercion.

In the case of **Ranganayakamma v. Alwar Setti**, A Hindu Widow of 13, was forced to adopt a boy under threat that her husbands dead body would not be allowed to be removed for cremation unless she adopts the boy. The widow adopted the boy and subsequently applied for cancellation of the adoption. It was held that the adoption was voidable at her option as her consent was obtained by coercion because preventing the dead body from being removed for cremation is an offence under Section 297 of the Indian Penal Code.

2) **Threatening to commit any act forbidden by the Indian Penal Code**: From the definition you will observe that not only the committing of an act forbidden by the Indian Penal Code amounts to coercion but **even a threat to commit such act amounts to coercion**. Thus, a threat to shoot, to murder, to kidnap or to cause bodily injury will amount to coercion. For example, A threatens to shoot B, if he does not sell his ship to A for Rs. 1,00,000. B agrees to sell his ship to A. Here the consent of B has been obtained by coercion.

   As per the explanation of Section 15, **it does not matter whether the Indian Penal Code is or is not in force in place where the coercion is employed.** If the suit is filed in India, this provision will apply. For example, A, on board an English ship on the high seas, causes B to enter into an agreement by an act amounting to criminal intimidation under the Indian Penal Code. A, afterwards sues B for breach of contract at Calcutta. A has employed coercion, although his act is not an offence by the law of England and although Section 506 of the Indian Penal Code was not in force at the time when, or the place where, the act was committed.

3) **Unlawful detaining of any property**: If a person unlawfully detains the property of another person and compels him to enter into a contract with him, the consent is said to be induced by coercion. For example, an agent refused to hand over the account books of the principal to the new agent appointed in his place unless the principal released him from all liabilities. The principal had to give a release deed as demanded. It was held that the release was not binding because the consent of the principal was obtained by exercising coercion (**Muthia v. Karuppan**).

4) **Threatening to detain any property unlawfully**: If a threat is held out to detain any property of another person, this also amounts to coercion. In **Banraj v. The secretary of State**, the Government gave a threat of attachment against the property of A for the recovery of a fine due from B, the son of A. A paid the fine. It was held that the consent of A was induced by coercion and he could recover the amount paid under coercion.

5) **Intention of causing any person to enter into an agreement :** The act of coercion must have been done with the object of inducing or compelling any person to enter into a contract.

   From the above discussion it becomes clear that the definition does not say anywhere as to by whom or against whom coercion can be exercised.

Hence, **whether the act of coercion is directed against the promisor or any other person in whose welfare the promisor is interested, the consent will not be free**. For example, A threatens to kill B's son C if B refuses to sell his car to him. Here, the threat is directed against C (B's son). So, the consent is treated as induced by coercion. Similarly, it is not necessary that the threat should come from a party to the contract, it may come from a stranger, For example, A threatens to kill B if he does not sell his house to D. B agrees to sell his house to D. Though A is a stranger to the contract, the consent is caused by coercion. What is important, therefore, is that a forbidden act was involved to obtain the consent of the other party. Whether it moves from the party or a stranger to the contract, is immaterial.

Threat to file a Suit

Sometimes a doubt may arise whether a threat to file a suit amounts to coercion or not. You should know that a threat to file a civil or criminal suit does not amount to coercion because it is not forbidden by the Indian Penal Code. However, a threat to file a suit on false charge amounts to coercion since such an act is forbidden by the Indian Penal Code.

Threat to Commit Suicide

Under the Indian Penal Code a suicide and a 'threat to commit suicide' are not punishable. But, an attempt to commit suicide is punishable. Now, the questions arises whether a 'threat to commit suicide' shall amount to coercion or not. This point was considered by Madras High Court in the case of **Ammiraju v. Seshamma**. In this case a person, by a threat to commit suicide, induced his wife and son to execute a release deed in favour of his brother in respect of certain property. The transaction was set aside on the ground of coercion. The court held by majority that though a threat to commit suicide is not punishable under the Indian Penal Code, it is deemed to be forbidden by that code.

4.4.2 Effect of Coercion

The effect of coercion is explained in Sections 19 and 72 of the Act. Section 19 provides that when the consent of a party to an agreement is obtained by coercion, the contract is voidable at the option of the party whose consent was not free (also called aggrieved party). In other words, it is upto the aggrieved party to decide whether to set aside the contract or perform it. If, however, the aggrieved party decides to avoid the contract, he cannot be compelled to perform his promise. But in that case, he has to restore any benefit received by him under the contract, to the other party from whom it had been received (Section 64). For example, A threatens to kill B if he refuses to sell his scooter for Rs. 2,000 to A. B sells his scooter to A and receives the payments. Here B's consent was not free and if B decides to avoid the contract then he will have to return Rs. 2,000 which he had received from A.

Section 72 clearly provides *a person to whom money has been paid or anything delivered under coercion, must repay or return it.* For example, a railway company refused to deliver certain goods to the consignee, except upon the payment of some illegal charges for carriage. The consignee paid the illegal charges in order to obtain the goods. Here he is entitled to recover so much amount of the charges as were illegal and excessive.

4.4.3 Burden of Proof

The burden of proving that consent was induced by coercion lies on the party who wants to avoid the contract. In other words, it is for the aggrieved party to prove that his consent was not free. This could be done by proving that he would not have entered into this contract had coercion not been employed.

4.5 UNDUE INFLUENCE

4.5.1 What is Undue Influence?

The second factor which affects consent and makes it unfree, is undue influence. The term 'undue influence' means the improper or unfair use of one's superior power in order to obtain the consent of a person who is in a weaker position. Section 16 (i) of the Contract Act defines undue influence as '*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.*

If we analyse this definition, two essentials of undue influence become clear:

i) the relations subsisting between the parties should be such that one of them is in a position to dominate the will of the other, and

ii) the dominant party should have used that position to obtain an unfair advantage over the other.

Both the characteristics must be present simultaneously. The presence of one without the other will not invalidate the contract on the ground of undue influence.

Examples

a) A, a lady gifted all her property to B, her spiritual guru so that she may secure benefits to her soul in next world. Later on, she disputed the validity of the gift deed. Here, the spiritual guru was in a position to dominate the will of his disciple A and by using his strong position obtained an unfair advantage. Hence, it was held that the consent of A was obtained by undue influence.

b) A was suffering from a number of ailments and B was treating him. B by exercising his influence over A as his medical attendant induced A to agree to pay B an unreasonable sum for his professional services. In this case B has used his superior position to obtain an unfair advantage over A.

Thus, you observe that undue influence compels a person in a weaker position to do something which he otherwise would not have done had he been left free to do the things. Undue influence destroys the free mind of a person and compels him to do something which is against his will. Thus, undue influence is a kind of mental pressure and not a physical coercion.

4.5.2 Presumption of Domination of Will

You have learnt that undue influence is involved only when one party is in a position to dominate the will of the other. Now the question arises as to when can a person be said to be in a position to dominate the will of the other. Answer to

this question is provided by Section 16 (2) of the Act. It states that a person is deemed to be in a position to dominate the will of another where:

i) **He holds a real or apparent authority over the other:** Examples of such cases are relations between master and the servant, parent and child, income tax officer and assessee.

ii) **He stands in a fiduciary relation to the other**: It means a relationship based on trust and confidence. The category of fiduciary relation is very wide. It includes the relationship of guardian and ward, spiritual adviser (guru) and his disciples, doctor, and patient, solicitor and client, trustee and beneficiary. In these cases presumption of domination of will arise. You should note that by judicial decisions it has been held that undue influence cannot be presumed between husband and wife, landlord and tenant, and creditor and debtor. The wife should not be paradanashin otherwise the presumption of domination arises.

iii) **He makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress.** Persons of weak intelligence, old age, indifferent health or those who are illiterate can be easily influenced. Hence, the law gives them protection. For example, A, an illiterate old man of about 90 years, physically in firm and mentally in distress, executed a gift deed of his properties in favour of B, his nearest relative who was looking after his daily needs and managing his cultivation. The court held that B was in a position to dominate the will of A **(Sher Singh v. Prithi Singh)**.

4.5.3 Effect of Undue Influence

If the consent of a party is induced by undue influence, the contract is voidable at the option of the party whose consent has been so caused. Section 119 A of the Act states the effect of undue influence *as when consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. Any such contract may be set aside either absolutely, or, if the party who was entitled to avoid has received any benefit thereunder, upon such terms and conditions as the court may seem just.* For example, A, a money-lender, advanced Rs. 100 to B, an agriculturist, and by undue influence, induced B to execute a bond for Rs. 200 with an interest at 6 percent per month. The court may set the bond aside, ordering B to repay Rs. 100 with such interest as may seem just.

In case of coercion, you learnt that if the aggrieved party decides to avoid the contract, he has to return or restore the benefit received by him. But, when a contract is avoided on the ground of undue influence, the court has the discretion to ask the aggrieved party for refunding the benefit either in full or in part or set aside the contract without any direction to the aggrieved party to refund the benefit.

4.5.4 Burden of Proof

When a party to a contract decides to avoid the contract on the ground of undue influence, he will have to prove that

i) **the other party was in a position to dominate his will:** It may be remembered that mere proof of nearness of relations is not sufficient for the

court to assume that one person was in a position to dominate the will of the other, the dominating position of the stronger party has to be proved.

ii) **the other party actually used his influence to obtain an unfair advantage**. The aggrieved party has not only to prove the dominating position of the stronger party but he has also to show that the stronger party had actually used his position and influenced his will to obtain an unfair advantage over him.

When the weaker party has proved the above mentioned two points, it is then for the stronger party to prove that he has not used any undue influence and show that the consent of the other party was freely obtained.

The above provision is contained in Section 16 (3) of the Contract Act which states that, *Where a person who is in a position to dominate the will of another enters into a contract with him, and the transaction appears, on the face of it or in the evidence adduced, to be unconscionable, the burden of proving that such contract was not induced by undue influence shall be upon the person in a position to dominate the will of the other.*

Unconscionable Transactions

You will notice that in Section 16 (3) the term 'unconscionable transactions' has been used. The transaction is said to be unconscionable when a person who was in a position to dominate the will of the other makes use of his position and enters into a contract which is of great benefit to himself and is unfair to the other party. In other words, if the stronger party makes an exorbitant profit of the other's distress, the transaction will be unconscionable i.e., it is something which shocks the conscience.

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In case of unconscionable transactions, the stronger party has to prove that the contract is not induced by any undue influence. For example, A, being in debt to B, the money-lender of his village, contracts a fresh loan on terms which appear to be unconscionable. It lies on B to prove that the contract was not induced by undue influence.

You should note that simply because the rate of interest is very high, it does not become an unconscionable transaction. For example, A applied to a banker for a loan at a time when there was stringency in the money market. The banker declined to make the loan except at an unusually high rate of interest. A accepted the loan on these terms. This was a transaction in the ordinary course of business and the contract was not induced by undue influence. Thus, a transaction will not be set aside merely because the rate of interest is too high. However, if the rate of interest is so high that the court considers it unconscionable, say when the interest rate is 75 per cent or 100 per cent per annum, the court may modify the rate of interest. Example A, a poor Hindu widow was in great need of money to establish her right to maintenance. She took a loan of Rs. 1,500 bearing a rate of interest of 100% p.a. the court held it to be an unconscionable transaction and modified the interest rate to 24% p.a. **(Ranee Annapurni v. Swaminatha)**.

You should also note that a party to a contract cannot avoid it on the ground of undue influence by merely showing that the transaction is unconscionable. He will also have to prove that the other party was in a position to dominate his will and he has used that position to obtain an unfair advantage.

The presumption of undue influence can be rebuted by showing that

i) the stronger party had made a full disclosure of all the facts to the aggrieved party before making the contract,

ii) the price was adequate, and

iii) the weaker party was in receipt of competent independent advice before entering into the contract.

Contracts with Pardanashin Woman

A pardanashin woman is one who observes complete seculsion i.e., who does not come in contact with people other than her family members. Law provides a special protection to pardanashin woman on the ground of their being ignorant so far as the worldly knowledge goes. A contract with a pardanashin woman is presumed to have been induced by undue influence. The burden of proving that no undue influence was used lies on the other party. The other party will have to prove that (i) the terms of the contract were fully explained to her, (ii) she understood the implications, (iii) free independent advice was available to her, and (iv) she freely consented to the contract. Here you should note that this protection is available only to a woman who observes complete parda. Some degree of parda or seculsion is not sufficient to entitle her to get special protection **(Sheikh Ismail v. Amir Bibi).**

4.6 DISTINCTION BETWEEN COERCION AND UNDUE INFLUENCE

In case of both coercion and undue influence the consent is not free and the contract is voidable at the option of the aggrieved party. But there are some basic points of difference between the two. These are as follows:

	Coercion	Undue Influence
1)	Relationship between the parties is not necessary.	Some sort of relationship must exist between parties.
2)	Consent is given under the threat of an offence.	Consent is obtained by dominating the will, no offence is committed.
3)	It involves physical force or threat.	It involves moral pressure.
4)	It may move from even a stranger and may be against the promisor himself or a person in whose welfare the promisor is interested.	It is employed by the party to the contract.
5)	When the contract is avoided, any benefit received has to be restored or refunded.	When the contract is avoided, it is at the discretion of the court to direct the aggrieved party to restore or refund the benefit received.

Check Your Progress A

1) Define consent.

....

....

....

2) When is consent said to be free?

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....

3) What is coercion?

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....

....

4) When is a party said to be in a position to dominate the will of another?

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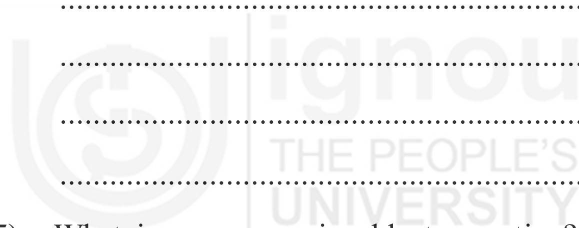
....



....

....

5) What is an unconscionable transaction?

....

....

....

....

6) State whether the following statements are True or False.

   i) In the absence of consent, there can be no contract. ....

   ii) A threat amounting to coercion must necessarily proceed from a party to the contract. ....

   iii) When consent is obtained by coercion, the contract is void. ....

   iv) A threat to commit suicide amounts to coercion ....

   v) Undue influence involves use of moral pressure ....

   vi) There is a presumption of undue influence in the relationship of creditor and debtor. ....

   vii) Undue influence can be exercised only by a party to the contract. ....

4.7 FRAUD

4.7.1 What is Fraud?

Fraud simply means a wilful wrong representation of fact, made by a party to a contract with the intention to deceive the other party or to induce him to enter into a contract. The term 'fraud' is defined by Section 17 of the Indian Contract Act as follows:

"Fraud means and includes any of the following acts committed by a party to a contract or by any one with his connivance or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

i) the suggestion, as to a fact, of that which is not true, by one who does not believe it to be true;

ii) the active concealment of a fact by one having knowledge or belief of the fact;

iii) a promise made without any intention of performing it;

iv) any other act fitted to deceive;

v) any such act or omission as the law specially declares to be fraudulent."

From the analysis of the above definition it follows that the following elements must be present in the act to constitute fraud.

1) **The fraud must be committed by a party to the contract by or any one with his connivance, or by his agent**. The fraud by a stranger to the contract does not affect the validity of the contract. For example, A was induced to buy shares of a company on the basis of a false statement made by B. B was neither the director nor the representative of the company, he was a mere stranger. Hence, A cannot avoid the contract on the ground of fraud because the false statement was made by a stranger to the contract and not by the company or its agent. But, if the false statement had been made by a director of the company, A could avoid the contract.

2) **The fraud must be committed with an intention to deceive the other party**. For example, A intending to deceive B makes a false statement to him that 100 units are manufactured every month in his factory, though A is aware that only 75 to 80 units are produced every month. B is induced to buy the factory. Here B's consent is obtained by fraud.

3) **There must be a representation or assertion and it must be false**. To constitute fraud there must be some representation or assertion which is false and the party making it knows that it is false. Example, A while selling his scooter to B says that it is brand new knowing fully well that it is a used one. A's statement amounts to fraud.

   Sometimes it may so happen that when a representation was made it was true, but before the contract is entered into, it becomes untrue and this fact is known to the party. In such a situation, it must be corrected. If it is not corrected, it will amount to fraud. In this connection you should also note

that if the person making representation honestly believes his statement to be true, he cannot be held liable for fraud, no matter how ill-advised, negligent or stupid he might have been. In order to constitute fraud, the false representation must have been made intentionally.

4) **The representation must relate to a fact**. A mere opinion, a statement of expression or intention or puffing expression is not treated as fraud. For example, A says to B while selling his horse, "my horse is as good as that of Y". This is a statement of opinion. But, if A says that this horse cost him Rs. 5,000, it becomes a statement of fact and if it is incorrect it amounts to fraud.

5) **Active concealment of a fact also amounts to fraud**. When the party takes positive steps to prevent an information from reaching the other party it is called active concealment and this amounts to fraud. For example, A, a horse dealer showed a horse to B. A knew that the horse had a cracked hoof which he had filled up in such a way as to defy detection. The defect was subsequently discovered by B. So, he refused to buy the horse. It was held that the contract could be avoided by B as his consent was obtained by fraud.

6) **The fraud must have actually deceived the other party**. The act committed with intent to deceive must actually deceive. The party must have relied on it to accord his consent. In other words, an attempt to deceive the other party by which the other party is not actually deceived is not fraud. In **Horsfall v. Thomas,** A had a defective cannon. In order to conceal it, he put a metal plug on it. B did not examine the gun and bought it. The cannon burst before the payment was made by B. B refused to pay. It was held that B was bound to pay because he was not actually deceived. He would have bought the cannon even if the plug had not been inserted, he never examined it. Thus, it can be said that **a deceit which does not deceive is not fraud**.

7) **The party acting on the representation must have suffered some loss**. It is a common rule that "there can be no fraud without damage and there can be no damage without an injury". The damage or injury may be in the form of loss of money or money's worth or in some other form.

4.7.2 Does Silence Amount to fraud?

Mere silence on the part of a party to the contract about certain material facts relating to the subject matter of the contract does not generally amount to fraud. The general rule is that a party to the contract is under no legal obligation to disclose the whole truth to the other party or to give him the whole information in his possession. This rule is given in Explanation to Section 17 which says "*Mere silence as to facts likely to effect the willingness of a person to enter into a contract is not fraud*". For example, A sells by auction to B, a horse which A knows to be unsound. A says nothing to B about the horse's unsoundness. This is not a fraud.

However, there are two exceptions to this rule in which silence also amounts to fraud. These are as follows.

1) **Where the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak.** Such duty to speak arises in the following cases.

i) **Fiduciary relationship**

Where one party reposes trust and confidence in the other, the party must reveal the truth. For example, A sells by auction a horse to B, his daughter who has just come of age. Here, the relation between the parties are such that it becomes A's duty to tell B about the unsoundness of the horse.

ii) **Contracts of absolute good faith**

Where one party has to depend upon the good faith of the other, the other party is bound to speak. For example, all contracts of insurance are contacts based on good faith and it is the duty of the proposer to make full disclosure of all material facts to the insurance company. If an assured conceals the material facts like long illness, the insurance company can avoid the contract on the ground of fraud. Similarly, contracts of family settlements, marriage and allotment of shares, sale of immovable property, guarantee, etc. are such where full disclosure must be made.

2) **Where the silence is, in itself, equivalent to speech**. Sometimes, the silence is equivalent to speech. In such cases, the silence of a person amounts to fraud. For example, A is selling his horse to B. The horse appears to be sound. Even then B says to A, "If you don't deny it, I shall assume that the horse is sound" A says nothing. Here A's silence is equivalent to speech.

4.7.3 Consequences of Fraud

When consent to a contract is induced by fraud, the contract is voidable at the option of the party whose consent was so caused. In case of fraud, the aggrieved party usually has the following remedies:

1) He can rescind (cancel) the contract, but it must be done within a reasonable time. The right to avoid the contract is, however, lost in the following cases.

   i) When the party whose consent was caused by fraudulent silence had the means of discovering the truth with ordinary diligence;

   ii) Where the party was not defrauded i.e., the party gave the consent in ignorance of fraud;

   iii) Where a party, after becoming aware of the fraud, takes a benefit under the contract or affirms it in some other way;

   iv) Where an innocent third party, before the contract is rescind, acquires, for consideration; some interest in the property passing under the contract; or

   v) Where the parties cannot be restored to their original position.

2) If the party whose consent was not free thinks it proper to accept the contract, he may do so and insist upon its performance. The second para of Section 19 provides that a party whose consent was caused by fraud may, if he thinks fit, 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. For example, A fraudulently informs B that A's estate is free from encumbrances. B, believing the statement to the true, bought the estate. It was later discovered that the estate was subject to a mortgage. In this

case, B may either avoid the contract or insist on its being carried out subject to the mortgage debt being redeemed.

3) The aggrieved party can also sue for damages. Fraud is a civil wrong. Hence, compensation can be claimed. For example, a party suffers some injury because of the unsound horse. If the fact of the unsoundness of horse was not disclosed despite enquiry, due compensation can be demanded.

4.8 MISREPRESENTATION

4.8.1 What is Misrepresentation?

The word representation means a statement of fact made by one party to the other, either before or at the time of making the contract, with regard to some matter essential for the contract, with an intention to induce the other party to enter into contract. **A representation, when wrongly made, either innocently or intentionally, is called 'misrepresentation'**. You know when a wrong representation is made wilfully with the intention to deceive the other party, it is called fraud. But, when it is made innocently i.e., without any intention to deceive the other party, it is termed as 'misrepresentation'. In such a situation, the party making the wrong representation honestly believes it to be true. For example, A while selling his car to B, informs him that the car runs 18 kilometers per litre of petrol. A himself believes this. Later on, B finds that the car runs only 10 kilometers per litre. This is a misrepresentation by A.

Section 18 of the contract Act classifies acts of misrepresentation into the following three groups:

1) **Positive assertion**: When a person makes a positive statement of material facts honestly believing it to be true though it is false, such act amounts to misrepresentation. For example, A while selling his farm to B, tells him that 100 quintals of rice are produced in his farm. A honestly believes the statement to be true. Later on, it is found that the farm produces only 80 quintals of rice. Here, A has made a misrepresentation.

2) **Breach of Duty**: Section 18(2) says that any breach of duty which, without an intent to deceive, gives an advantage to the person committing it, or anyone under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him, amounts to misrepresentation. In such a case, there is no intention to deceive, but party representing commits a breach of duty which he owes to the other party. A breach of duty would also exist where a party bound to disclose certain information does not do so. Such non-disclosure would also amount to misrepresentation. For example, in a life policy, the assured does not disclose the fact that he had previously suffered from some serious ailments. The non-disclosure, however, innocent it may be, would entitle the insurer to avoid the contract on the ground of misrepresentation of facts. Such a duty exists between banker and customer, landlord and tenant and all contracts of utmost good faith. Such cases can also be termed as 'constructive fraud'.

3) **Inducing mistake about subject-matter**: The subject matter of every agreement must clearly be understood by the concerned parties. If one of the parties, leads the other, even innocently, to commit a mistake regarding the nature or quality of the subject-matter, it is considered misrepresentation.

Section 18(3) of the Act says when a party causes, however innocently, the other party to the agreement to make a mistake as to the substance of the thing which is the subject-matter of the contract, this is misrepresentation. For example, 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 register. It turned out that the registered tonnage was 3,045 tons. A refused to accept the ship in fulfilment of the charter party, and it was held that he was entitled to avoid the charter party by reason of the erroneous statements as to tonnage **(The Oceanic Steam Navigation Co., V. Soonderdas Dhrumsy)**.

4.8.2 Essentials of Misrepresentation

1) The representation should be made innocently, honestly believing it to be true and without the intention of deceiving the other party.

2) Misrepresentation should be of facts material to the contract. A mere expression of one's opinion is not a statement of facts.

3) The representation must be untrue, but the person making it should honestly believe it to be true.

4) The representation must be made with a view to inducing the other party to enter into contract and the other party must have acted on the faith of the representation. A party cannot complain of misrepresentation if he had the means of discovering the truth with ordinary diligence.

5) The false representation must have been made by one party to the contract to the other who is misled. If it is not addressed to the party who is misled, then it is not misrepresentation. In **Peek v. Gurney**, some false statements were made in the prospectus of a company. A purchased some shares from B, the allottee, on the basis of prospectus. A wanted to avoid the contract on the ground of misrepresentation. It was held that he cannot avoid the contract because the prospectus was addressed to the first allottee and not to A.

4.8.3 Effect of Misrepresentation

Section 19 of Contract Act provides that when consent to an agreement is caused by misrepresentation, the agreement is voidable at the option of the party whose consent was so caused. Thus, the aggrieved party has the following two rights:

a) He can rescind the contract. This right is available only in such cases where he was not in a position to discover the truth with ordinary diligence. For Example, A by misrepresentation, leads B erroneously to believe that 500 quintals of indigo are made annually at A's factory. B examines the records of the factory, which show that only 400 quintals of indigo have been produced. After this B decides to buy the factory. Here, the contract cannot be avoided by B on the ground of misrepresentation.

b) If the aggrieved party thinks it proper, he may accept the contract and insist upon its performance. He may compel the other party to put him in the position in which he would have been if the representation made had been true.

Loss of Right to rescind the contract: You have seen that the party whose consent was caused by misrepresentation can avoid or rescind the contract. However, this right is lost in the following cases:

i) If he could discover the truth with ordinary diligence.

ii) If his consent is not induced by misrepresentation.

iii) If he, after coming to know about the misrepresentation, expressly affirms the contract or acts in such a manner which shows that he has accepted it.

iv) If, before the contract is rescinded, the third party acquires some right in the subject-matter in good faith and for some consideration.

v) If the parties cannot be restored to their original position, e.g., where the subject matter of the contract has been consumed or distoyed.

4.9 DISTINCTION BETWEEN FRAUD AND MISREPRESENTATION

Fraud and misrepresentation have many points in common. For example, in both cases a false representation is made by a party. Similarly, in both cases the contract is voidable. But there are many points of difference. These are summarised as follows:

	Fraud	Misrepresentation
1)	Wrong statement is made intentionally.	Wrong statement is made innocently.
2)	The person making the wrong statement does not believe it to be true.	The person making the wrong statement believes it to be true.
3)	There is an intention to deceive.	There is no intention to deceive.
4)	Besides rescinding the contract, the aggrieved party can also claim damages.	The aggrieved party can rescind the contract but cannot claim damages.
5)	Except where the silence amounts to fraud, the contract is voidable even if the party defrauded had the means of discovering the truth with ordinary diligence.	The aggrieved party cannot avoid the contract if he had the means of discovering the truth with ordinary diligence.

Check Your Progress B

1) Define 'Fraud'.

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2) What is 'Misrepresentation'?

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3) What are the consequences of fraud?

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4) State whether the following statements are True or False.

   i) When a person positively asserts that a fact is true when his information does not warrant it to be so, though he believes it to be true, there is misrepresentation.

   ii) A contract induced by fraud is voidable at the option of either party to the contract.

   iii) A mere attempt to deceive is fraud whether the other party has been deceived or not.

   iv) Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud.

   v) If there is no damage, there is no fraud.

   vi) The aggrieved party in case of active fraud loses the right to rescind the contract if he had the means of discovering the truth by ordinary diligence.

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4.10 MISTAKE

You know that if the consent is obtained by coercion, undue influence, fraud, misrepresentation or mistake, it is not considered as free consent. You have learnt about coercion, undue influence, fraud and misrepresentation. We shall, now discuss about 'mistake'.

Mistake may be defined as the erroneous belief concerning something. Whenever an agreement is made under a mistake, there is no consent, and the agreement is not valid. Broadly speaking, Mistake may be of two types: (1) Mistake of Law and (2) Mistake of fact. Mistake of law can be further classified into (a) mistake of Indian law, and (b) mistake of foreign law. Similarly, mistake of fact can be (a) bilateral mistake or (b) unilateral mistake. Look at figure 4.2, for detailed classification of mistakes.

Types of Mistakes

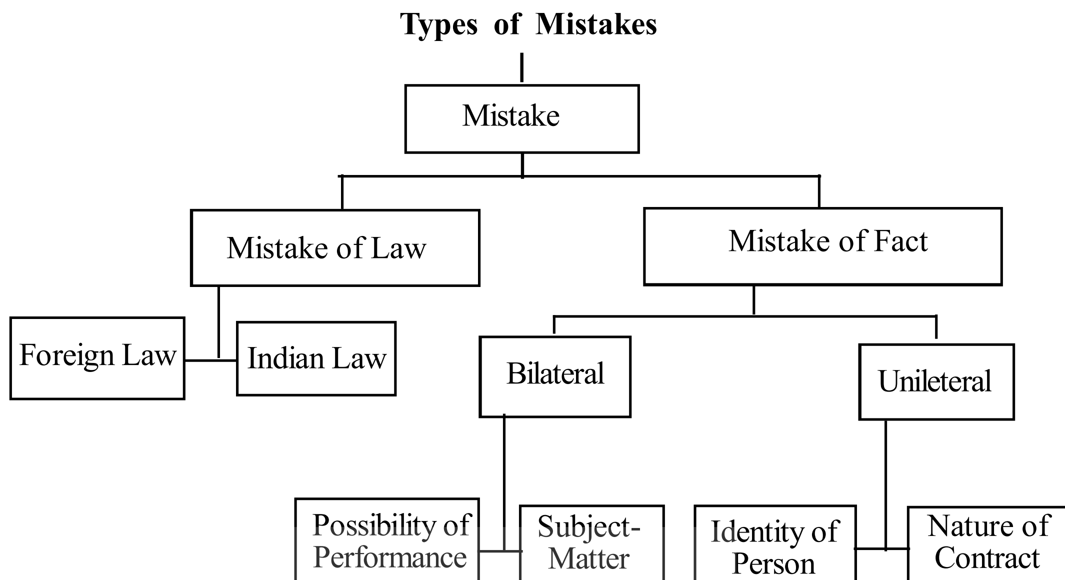

Fig. 4.2

4.10.1 Mistake of Law

Mistake of law may be (a) mistake of Indian Law, or (b) mistake of foreign law.

a) **Mistake of Indian Law**: The general rule is that mistake of law of the land is no excuse. Section 21 lays down that *a contract is not voidable because it was caused by a mistake as to any law in force in India.* It is because every one is supposed to know the law of the country and if a person does not know the law of his country, then he must suffer the consequences. Thus, a mistake of Indian law will not affect the validity of the contract. For example, A and B make a contract grounded on the erroneous belief that a particular debt is time barred by the Indian Law of limitations. This contract is valid and not voidable.

b) **Mistake of Foreign Law**: A person is supposed to know the laws of his country but he cannot be expected to know the laws of other countries. Therefore, the rule that 'ignorance of law is no excuse' cannot be applied to foreign law. A mistake of foreign law is treated as a mistake of fact. Section 21 lays down that a mistake as to a law not in force in India has the same effect as a mistake of fact. Hence, the contract will be void, if both the parties are under a mistake as to a foreign law.

4.10.2 Mistake of Fact

You have learnt that mistake of fact may be classified into two groups.viz., (a) Bilateral mistake, and (b) Unilateral mistake. Let us now understand the nature, and effect of such mistakes.

Bilateral Mistake: When both the parties to an agreement are under a mistake of fact essential to the agreement, the mistake is known as bilateral mistake of fact. In such a situation, there is no agreement at all because there is complete absence of consent. Section 20 of the Act provides *where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.* Thus, for declaring an agreement void under this section, the following three conditions must be satisfied.

i) **Both the parties must be under a mistake:** The mistake must be mutual. For example, A, having two cars, a Fiat and another Maruti, offers to sell his Fiat car to B and B not knowing that A has two cars, thinks of the Maruti car and agrees to buy it. In this case, there is no consent whatsoever. Therefore, the agreement shall be void.

ii) **Mistake must be of fact and not of law:** Explanation to Section 20 provides that an erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not treated as mistake relating to a matter of fact. For example, A buys a painting believing it to be worth Rs. 10,000 while in fact it is worth only Rs. 2,000. The contract remains valid. A will have to blame himself for ignorance of the true value of the painting.

iii) **Mistake must relate to as essential fact:** The mistake must relate to a matter of fact which is essential to the agreement. In other words, only such mistake of fact that goes to the root of the agreement, renders the agreement void. For example, A agreement 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, because the mistake relates to something i.e., the horse, which is essential to the contract.

A bilateral mistake may be (a) mistake as to the subject-matter, or (b) mistake as to the possibility of performance.

a) **Mistake as to the subject-matter of the contract:** Where both the parties to an agreement are under a mistake relating to the subject-matter of the contract, the agreement is void. A mistake as to the subject-matter may take following forms :

   i) **Mistake as to the existence of the subject-matter:** When both the parties are under a mistake regarding the existence of the subject-matter, the agreement is void. For example, A agrees to sell to B a specific cargo of goods supposed to be on its way from England to Bombay. It turns out that, before the day of the bargain, the ship carrying the cargo had been cast away and the goods lost. Neither the party was aware of these facts. The agreement is void.

   ii) **Mistake as to the identity of subject-matter:** Where the parties to a contract have different subject-matter in their minds i.e., one party had one thing in mind and the other party had another, the agreement is void because there is no consensus-ad-idem. For example, A offers to sell his old Delhi house to B. A had another house in South Delhi. B thinks he is buying the South Delhi's house. There is no agreement between A and B.

   iii) **Mistake as to the title of the subject-matter:** Sometimes the buyer already owns the property which a person wants to sell to him, but the concerned parties are not aware of this fact. In such a case, the agreement is void as there is a mistake about the title of the subject-matter (**Cooper v. Phibbs**).

   iv) **Mistake as to the quantity of the subject-matter:** Where both the seller and the buyer make a mistake regarding the quantity of the subject-matter, the agreement is void. In the case of **Henked v. Pape**, P inquired about the price of rifles from H suggesting that he might buy fifty rifles. On receiving the quotation, P telegraphed "send three rifles".

But, because of the mistake of the telegraph authorities, the message transmitted was "send the rifles" H despatched fifty rifles. P accepted three rifles and returned the remaining forty seven rifles. It was held that there was no contract. However, P was liable to pay for three rifles on the basis of an implied contract.

v) **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. For example, A contract is to sell a particular horse to B. A and B believe it to be, a race horse. But, it turns to be a cart horse. The agreement is void.

vi) **Mistake as to the price of the subject-matter:** Where there is a mutual mistake as to the price of the subject-matter, the agreement is void. For example, where a seller of certain goods mentioned in his letter the price as Rs. 1,250 when he really intended to write Rs. 2,250, the agreement is void. In this connection, you should remember that an erroneous opinion as to the value of the thing which forms the subject-matter of the agreement is not treated as a mistake of fact.

b) **Mistake as to the possibility of performance**: If the parties to the agreement believe that the contract is capable of performance, while in fact it is not so, the agreement is treated as void on the ground of impossibility. It may be (i) a physical impossibility or (ii) a legal impossibility.

i) **Physical impossibility:** A contract for the hiring of a room for witnessing the coronation procession of Edward VII was held to be void because unknown to the parties the procession had already been cancelled and there is no question of witnessing it (**Griffith v. Brymer**).

ii) **Legal impossibility:** An agreement is void if it provides that something shall be done which cannot legally be done.

Unilateral Mistake

The term 'unilateral mistake' means where only one party to the agreement is under a mistake. Generally, a unilateral mistake does not make the agreement void. According to Section 22, a contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact. If a man due to his own negligence or lack of reasonable care does not ascertain what he is contracting about, he must bear the consequences. For example, A sold oats to B by sample and B, thinking that they were old oats, purchased them. In fact, the oats were new. It was held that B was bound by the contract, (**Smith v. Hughes**).

In some cases, however, a unilateral 'mistake may be fundamental and may affect the character of the contract. In such a situation, the agreement is void. Thus, in the following cases, even though the mistake is unilateral, the agreement is void.

1) **Mistake as to the identity of the person contacted with**: Mistake as to the identity of the person violates a contract. For example, where A intends to contract only with B, but enters into a contract with C believing him to be B, the contract is void. It should be noted that a mistake about the identity of the contracting party will render the contract void only if (a) the identity of the party is of material importance to the agreement, and (b) the other party knows that he is not intended to be a party to the agreement. The following cases illustrate this point.

In the case of **Cundy V. Lindsay**, one Blenkarn knowing that Blenkiron & Co., were the reputed customers of Lindsay & Co. placed an order with Lindsay & Co. by imitating the signature of Blenkarn. The goods were then sold to Cundy, an innocent buyer. In a suit by Lindsay & Co. against Cundy for recovery of goods, it was held that as Lindsay never intended to contract with Blenkarn, there was no contract between them and as such even an innocent buyer (Cundy) did not get a good title. Hence, Cundy must return the goods or make payments of price.

In the case of **Lake v. Simmons**, a woman, by falsely misrepresenting her to be the wife of a well known Baron (a millionaire) obtained two pearl necklaces from a firm of jewellers on the pretext of showing them to her husband before buying. She pledged them with a broker, who in good faith, paid her Rs. 10,000. It was held that there was no contract between the jeweller and the woman and even an innocent buyer or a broker did not get a good title. The broker must return the necklaces to the jeweller. Here the jeweller intended to deal not with her but with quite a different person, i.e., the wife of a Baron.

In the case of **Said v. Butt**, S knew that on account of his criticism of the plays in the past, he would not be allowed entry at the performance of a play at the theatre. The managing director of the theatre, gave instructions that a ticket should not be sold to S. S, however, obtained a ticket through one of his friends. On being refused admission to the theatre, he sued for damages for breach of contract. It was held that there was no contract with S, as the theatre company never intended to contract with S.

2) **Mistake as to the nature of the contract**: A contract is void when one of the parties, without any fault of his own, makes a mistake as to the very nature of the contract. Thus, when a person is induced to sign a written document containing a contract fundamentally different in nature from what he thinks he is signing, the contract shall be void.

In the case of **Foster v. Mackinnon**, an old illiterate man was induced to sign a bill of exchange, by means of a false representation that it was a mere guarantee. Held, he is not liable for the bill as he never intended to sign a bill of exchange.

4.10.3 Effect of Mistake

While discussing various types of mistakes, the effect of each type of mistake has been clearly stated. It can now be summarised as follows:

1) Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void.

2) In most cases of unilateral mistake, the contract is not void. But, where unilateral mistake defeats the true consent of the parties, the agreement is treated as void.

3) Any person who has received any advantage under such agreement, he is bound to restore it, or to make compensation for it, to the person from whom he had received it.

4) A person to whom money has been paid or anything delivered by mistake must repay or return it.

Cheek Your Progress C

1) What is Mistake?

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2) When does unilateral mistake not make contract void?

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3) What is bilateral mistake?

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4) State whether the following statements are True or False.

   i) Where both the parties to an agreement are under a mistake as to a matter of fact, the agreement is voidable. ....

   ii) If both the parties believe the subject-matter of a contract to be in existence, which in fact is non existent, the contract is void. ....

   iii) An agreement which is not capable of being performed is void. ....

   iv) Ignorance of law is no excuse. ....

   v) A mistake regarding the identity of the person contracted makes the contract voidable. ....

   vi) A contract is void if one of the parties to the contract is under a mistake of fact. ....

4.11 LET US SUM UP

Two or more persons are said to consent when they agree upon the same thing in the same sense. Consent is said to be free when it is not caused by i) coercion, ii) undue influence, iii) fraud, iv) misrepresentation, or v) mistake.

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. In this case the contract is voidable.

Where the relations subsisting between the parties are such that one party can dominate the will of another and by using this position he obtains an unfair advantage over the other, the consent is said to have been caused by undue influence and the contract is voidable.

A person is deemed to be in a position to dominate the will of another (a) where he holds a real or apparent authority over the other, or where he stands in a fiduciary relation to the other, or (b) 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 distress.

Where a person who was in a strong position to dominate the will of the other and the transaction appears to be unconscionable, the burden of proving that the contract was not induced by undue influence shall lie upon the person who was in a strong position.

Willful wrong representation of material facts with the intention to deceive the other party is fraud. For a fraud, it is necessary that (i) a false representation or assertion is made, (ii) it must be of a fact, (iii) it must be made with the knowledge of its falsehood or without belief in its truth or is made recklessly, (iv) it must be made with the intention to deceive the other party, (v) the other party must have acted on the basis of such representation, and (vi) the other party must have suffered some loss. In case of fraud, the contract is voidable and the aggrieved party can also claim the damages.

Misrepresentation refers to a mis-statement of material facts made innocently or the non-disclosure of a material fact without any intention to deceive the other party. In case of misrepresentation, the contract is voidable but the damages cannot be claimed.

Mistake is an erroneous belief concerning something. Mistake may be a mistake of law or a mistake of fact.

Mistake of law can be of two types – (i) mistake regarding the law of the land (Indian laws), and (ii) mistake regarding foreign laws. A mistake of Indian law is not excusable, while a mistake of foreign law is treated as a mistake of fact. A mistake of fact can also be divided into two groups: (a) bilateral mistake, (b) unilateral mistake.

Bilateral mistake may relate to the subject-matter or the possibility of performance. Mistake of fact regarding subject-matter may be as to (i) existence of the subject-matter, (ii) identity of the subject-matter, (iii) title of the subject-matter, (iv) quantity of the subject-matter, (v) quality of the subject-matter, (vi) price of the subject-matter. Such mistake of fact make an agreement void.

A unilateral mistake, generally does not render the agreement void. But when there is a mistake regarding the identity of the person contracted with or it relates to the nature of the contract, the agreement is void,

4.12 KEY WORDS

Aggrieved Party: The party to an agreement whose consent is not free.

Bilateral Mistake: Where both the contracting parties are working under a common mistake.

Coercion: Committing or threatening to commit any act forbidden by the Indian Penal Code or detaining or threatening to detain any property of another to his prejudice with the intention of causing him to enter into an agreement.

Free Consent: Consent to an agreement without influence or pressure of any type.

Fraud: A false representation made wilfully with a view to deceive the other party.

Misrepresentation: A false representation made innocently, without any intention to deceive the other party.

Pardanashin Women: A woman who by custom or the country or usage of the particular community she belongs, is obligate to observe complete seclusion.

Undue Influence: Use of a position to dominate the will of another to obtain any unfair advantage over the other in connection with an agreement with him.

Unilateral Mistake: Where only one party to the contract is under a mistake.

4.13 ANSWERS TO CHECK YOUR PROGRESS

A) 6) i) True, ii) False, iii) False, iv) True, v) True, vi) False, vii) True

B) 4) i) True, ii) False, iii) False, i;) True, v) True, vi) False

C) 4) i) False, ii) True, iii) True, iv) True, v) False, vi) False.

4.14 TERMINALS QUESTTONS/EXERCISES

1) Define Consent. When is Consent said to be free?
2) What is the effect of coercion on the validity of the contract?
3) Does a threat to commit suicide amount to coercion? Explain.
4) When is a person deemed to be in a position to dominate the will of another?
5) Define fraud and point out its effects on the validity of the contract.
6) "Mere silence as to facts is not fraud". Explain with examples.
7) Distinguish between :
   i) Coercion and undue influence
   ii) Fraud and Misrepresentation
8) What is the position of a contract made with a pardanashin woman?
9) Define mistake and explain various types of mistakes.
10) Explain and illustrate the effect of a 'mistake of fact' on contracts.
11) On whom the burden of proof lies in case of undue influence? State the cases in which undue influence is presumed.
12) Answer the following problems giving reasons for your answer:
    i) A threatens to shoot B if he does not sell his scooter to him (A) for Rs. 1,000. B signs the necessary documents for the sale of scooter. Later on, B wants to avoid the contract. Will he succeed? If so, why?

       (Hint : B can avoid the contract on the ground of coercion).

    ii) Mahesh was suffering from some disease and was in great pain. His doctor agreed to treat him provided he signs a promissory note for Rs. 20,000. On recovering from the disease, Mahesh refused to honour the pro-note. Can the doctor recover the amount of the-promissory note?

(Hint : Doctor has employed undue influence on Mahesh. Mahesh is liable to pay only reasonable fee).

iii) Hari sells his horse to Rajesh. Hari knows that the health of the horse is unsound. Hari says nothing to Rajesh about the unsoundness of the health of horse. Is this contract valid?

(Hint : Yes, this contract is valid, because it is not the duty of the seller to disclose defects).

iv) N entered into a jeweller's shop and selected some jewels. She gave a cheque in the name of G.B., a man of repute. The jeweller accepted the cheque and allowed N to take the jewels. N pledged the jewels with B who had no knowledge of the fraud. Can the jeweller recover the jewels from B?

(Hint : No, the jeweller cannot recover the jewels from third party. It is not a mistake regarding the identity of person contracted with, but only about her attributes.)

v) Avinash, while selling an unsound horse to Rakesh puts on the stable's door a forged certificate from a veterinary doctor that the horse is sound. Rakesh sees the horse casually but does not notice the certificate and buys the horse. Rakesh wants to terminate the contract on grounds of fraud. Will he succeed?

(Hint : Rakesh will not succeed. His consent was not affected by the forged certificate).

vi) A sells a painting to B saying that it is an original work of Picaso. Unknown to both the parties, the original painting was stolen and its copy was placed there. Is the contract valid?

(Hint : The contract is void on ground of bilateral mistake as to the quality of the subject-matter).

vii) Prem offers to sell a painting to Vikas which Prem knows is the copy of a well known masterpiece. Vikas, thinking that the painting is the original one, decides to buy it at a very high price. Is this a valid contract?

(Hint : Yes, the contract is valid. Vikas has a wrong impression about the value of the painting),

Note: These questions and exercises will help you t o understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

M. C. Kuchhal, and Vivek Kuchhal, Business Law, Vikas Publishing House, New Delhi.

Avtar Singh, Business Law, Eastern Book Company, Lucknow.

S. N. Maheshwari and SK Maheshwari, Business Law, National Publishing House, New Delhi.

G. K. Kapoor Business Laws, Scholar Tech Press, New Delhi.

P. C. Tulsian and Bharat Tulsian, Business Law, McGraw Hill Education.

Sharma, J. P. and Sunaina Kanojia, Business Laws, Ane Books Pvt. Ltd., New Delhi.

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GENERAL LAW OF CONTRACT-II

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BLOCK 2 GENERAL LAW OF CONTRACT-II

In Block 1 you learnt about various essentials of a valid contract and studied detailed rules relating to the offer and acceptance, capacity of parties and free consent. In this block you will learn the details about consideration and the circumstances when an agreement is void. It also deals with various modes of the discharge of a contract and remedies for breach; and includes rules regarding contingent and quasi contracts.

This block contains the following units:

Unit 5 discusses the meaning of consideration and rules for a valid consideration. It also describes the concept of public policy and lists the agreements opposed to public policy.

Unit 6 deals with agreements which have been declared void and also discusses the rules relating to Contingent Contracts.

Unit 7 discusses the rules relating to the performance of contract and describes various modes of discharge of a contract.

Unit 8 described the meaning of breach, types of breach and various remedies available to the aggrieved party. It also lists the relationships resembling those of a contract (quasi contracts).

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UNIT 5 CONSIDERATION AND LEGALITY OF OBJECT

Structure

5.0 Objectives

5.1 Introduction

5.2 Meaning of Consideration

5.3 Legal Rules for Valid Consideration

5.4 Stranger to a Contract and Stranger to Consideration

5.5 Adequacy of Consideration

5.6 Legality of Agreements without Consideration

5.7 Legality of Object and Consideration

5.8 Agreements Opposed to Public Policy

5.9 Let Us Sum Up

5.10 Key Words

5.11 Answers to Check Your Progress

5.12 Terminal Questions

5.0 OBJECTIVES

After studying this unit, you should be able to:

- describe the meaning of consideration;
- explain lawful consideration and its significance in relation to the validity of a contract;
- explain how inadequacy of consideration does not affect the validity of a transaction;
- state the exceptions to the rule 'no consideration, no contract';
- explain when the object or the consideration shall be unlawful; and
- describe the agreements which are considered opposed to public policy.

5.1 INTRODUCTION

In Unit 1 you learnt about the essentials of a valid contract. One such essential, as per Section 10 of the Indian Contract Act, is 'lawful consideration'. In this unit you will learn about the meaning of consideration, rules of a valid consideration, effect of inadequate consideration on the validity of an agreement, enforceability of agreements without consideration and the circumstances under which consideration is regarded as unlawful. You will also study about the agreement which are declared opposed to public policy.

5.2 MEANING OF CONSIDERATION

In business law, the term 'consideration' is used in the sense of 'quid pro quo' which means 'something in return'. This 'something' may be some benefit, right, interest or profit that may accrue to one party or it may be some forbearance, detriment, loss or responsibility upon the other party. This explanation of consideration was given in a very popular English case of **Currie v. Misa**. Another simple and good description of 'consideration' is available in Sir Pollock's definition. In his book 'Pollock on Contracts', he says, "consideration is the price for which the promise of the other is bought, and the promise thus given for value is enforceable". Section 2(d) of the Indian Contract Act 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.*

Examples

1. A agrees to sell his house to B for Rs. 10,00,000. Here B's promise to pay Rs. 10,00,000 is the consideration for A's promise to sell the house and A's to sell the house is the consideration for B's promise to pay Rs. 10,00,000.

2. X promises his debtor Y not to file a suit against him for one year on Y's agreeing to pay him Rs. 1,000 more. Here the abstinence of X is the consideration for Y's promise to pay.

Thus, all contracts consist of two clearly separable parts (i) the promise, and (ii) the consideration for the promise. A person who makes a promise to do or to abstain from doing something usually does so as a return for 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. It should be noted, that a promise without consideration is purely gratuitous and, however, sacred and morally binding it may be, it cannot create a legal obligation. *"No consideration, no Contract" is the rule of law*. The following two cases prove this point.

Abdul Aziz v. Mazum Ali: In this case a person verbally promised the Secretary of the Mosque Committee to subscribe Rs.500 for rebuilding of a mosque. Later, he declined to pay the said amount. Held, there was no consideration and hence the agreement was void.

Kedarnath v. Gorie Mohammad: In this case the defendant had agreed to subscribe Rs. 100 towards the construction of a Townhall at Howrah. On the faith of the promise, the Secretary called for plans and entrusted the work to contractors and undertook liability to pay them. Held, the agreement was enforceable being one supported by consideration in the form of a detriment to the Secretary who had undertaken a liability to the contractors on the faith of the promise made by the defendant.

5.3 LEGAL RULES FOR VALID CONSIDERATION

If you analyse the definition of consideration as per Section 2(d), you may notice certain essential features which are necessary for consideration to be valid and

acceptable legally. These features are also known as the **legal rules for consideration**. Let us now study such rules in detail.

1. **Consideration must move at the desire of the promisor**: To make a contract binding and enforceable, it is not sufficient that there is consideration but also that consideration has been supplied at desire of the promisor. Thus, where an act is done at the desire of a third party and not the promisor, that act cannot constitute valid consideration. For example, D constructed a market at the instance of the Collector of a district. The occupants of the shops in the said market promised to pay D a commission on articles sold through their shops. Held, there was no consideration because the money was not spent by the plaintiff at the request of the defendants, but voluntarily for a third person and, thus, the contract was void **(Durga Prasad v. Baldeo)**.

   It does not mean, however, that a promisor must get the benefit personally. The consideration may accrue to the third party at the request or desire of the promisor. For example, A, who owes Rs.20,000 to B, persuaded C to pass a promissory note for the amount in favour of B. C promised B that he would pay the amount (by passing on a promissory note), and B credited the amount to A's Account in his books. The discharge of A's account was consideration for C's promise (though C the promisor had not the received benefit) **National Bank of Upper India v. Bansidhar**.

2. **Consideration may move from the promisee or any other person**: The second rule as to consideration is that the act which is to constitute consideration may be done by the promisee himself or by any other person. "Any other person" (that is, a person other than the promisee) is technically referred to as stranger to consideration. This is sometimes called as doctrine of constructive consideration. It means, that, as long as there is a consideration for a promise, it is immaterial who has furnished it.

   The case of **Chinnayya v. Ramayya** is a good illustration on the point. In this, case, A 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 the brother, agreeing to pay the annuity. Afterwards, she declined to fulfil her promise saying that no consideration had moved from her uncle ('A's brother') The Court, however, held that the words 'the promisee or any other person' in Section 2(d) clearly show that the consideration need not necessarily move from the promisee, it may move from any other person. Hence, A's brother was entitled to maintain the suit.

3. **Consideration may be past, present or future**: The words used in Section 2(d) are "has done or abstained from doing" refer to past. Similarly, the words "does or abstains from doing" refer to present, and the words "promises to do or to abstain from doing" refer to future. Accordingly in India, consideration may be past, present or future.

Past Consideration: Past consideration is something wholly done, forborne or suffered before the making of the agreement.

Examples

i. A, a minor, was given the benefit of certain services by the plaintiff. The plaintiff rendered those services, not voluntarily but at the desire of A. These services were continued even after majority at the request of A,

who subsequently promised to pay an annuity to the plaintiff. It was held that the past consideration was a good consideration (**Sindhe v. Abraham**).

ii. A renders some services to B at B's request in the month of November. In December B promises to pay A a sum of Rs. 100 for his services. The services of A will be past consideration. A can recover the past amount.

But under English Law past consideration is no consideration. Thus, if the above promise was made in England, it could not have been enforceable.

Present Consideration: Consideration which moves simultaneously with the promise is called present or executed consideration. 'cash sales' is an excellent example of the present consideration.

Future Consideration: When 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. For example, A promises B to deliver him 100 bags of wheat at a future date. B promises to pay for it on delivery.

4. **Consideration must be of some value**: Consideration as defined under Section 2(d) of the Indian Contract Act means some act, abstinence or promise on the part of the promisee or any other person which has been done at the desire of the promisor. Should it mean that even a worthless act will be sufficient to make a good consideration if it is only done at the promisor's desire. If, for example, A promises to give his new Maruti car to B, provided B will fetch it from the garage. The act of fetching the car cannot be any stretch of imagination be called a consideration for the promise. Yet it is the only act the promisor desired the promisee to do. Such an act no doubt, satisfies the words of the definition, but it does not catch its spirit. In **Chidambara v. P.S. Ranga**, Justice Subba Rao of Supreme Court observed that consideration shall be "something" which not only the parties regard but the law can also regard as having some value. Similarly, in **Kulasekaraperumal v. Pathakutty**, Justice Srinivasan of Madras High Court observed that though the Indian Contract Act does not in terms so require, consideration must be good or valuable. It must be real and not illusory. For example, A promises to pay an existing debt punctually if B, the creditor, gives him, some discount. The agreement is without consideration as the discount cannot be enforced as consideration being unreal and illusory.

5. **Consideration must be Legal**: Consideration which is not legal, naturally, has no value in the eyes of the law and, therefore, cannot be a real consideration.

Thus, the main points of Legal Rules for Consideration are as follows:

1. Consideration must move at the desire of the promisor
2. Consideration may be supplied by the promisee or any other person
3. Consideration may be past, present or future
4. Consideration must be of some value, i.e., it must be real and not illusory
5. Consideration must be legal.

5.4 STRANGER TO A CONTRACT AND STRANGER TO CONSIDERATION

You have learnt that in India, consideration is permitted to be supplied by any person and it need not necessarily be supplied by the promisee himself. Thus, the concept of 'stranger to consideration' is a valid and acceptable concept.

However, a stranger to the consideration must be distinguished from a stranger to a contract. A stranger to a contract means a person who is not a party to the contract. Such a person cannot, bring a valid suit.

For example, A who is indebted to B, sells his property to C and C promises to pay off the debt to B. In case C fails to pay, B has no right to sue C being stranger to the contract.

Exceptions

The aforesaid rule that a stranger to a contract cannot sue is, however, subject to certain exceptions. In other words, even a stranger to a contract may enforce a claim in the following cases:

1. **Beneficiary under trust or charge**

   In the case of trusts, the beneficiary may enforce the contract. In **Khwaja Muhammad v. Hussaini Begum**, H sued her father-in-law K to recover Rs. 15,000 being the arrears of allowance called **Kharchi-i-Pandan** – betel box expenses (Pinmoney) payable to her by K under an agreement made between K and H's father, in consideration of H's marriage to K's son D. Both H and D were minors at the time of marriage. The Privy Council held the promise to be enforceable by H.

2. **Marriage Settlement**

   On the same principle, the provision of marriage expenses of female members of a Joint Hindu Family entitles the female member to sue for such expenses on a partition between male members (**Rakhmanbai v. Govind**).

3. **Acknowledgement of liability or estoppel**

   In the case of an acknowledgement of liability or by past performance thereof. Where X receives money from Y for paying it to Z and X admits to Z the receipt of that amount, then X becomes the agent of Z and will be liable to pay the amount to him.

4. **Family Settlement**

   In the case of a family settlement, if the terms of the settlement are reduced into writing, the members of the family who originally had not been parties to the settlement, may enforce the agreement **(Shuppu v. Subramanium)**.

5. **Assignment of a contract**

   In the case of assignment of a contract, when the benefit under a contract has been assigned, the assignee can enforce the contract **(Kishan La1 Sadhu v. Pramila Bala Dasi)**.

5.5 ADEQUACY OF CONSIDERATION

In fact, adequacy of consideration is always the lookout of the promisor. Courts do not see whether every person making the promise has recovered full return for the promise. Thus, if 'A' promises to sell a house worth Rs. 8,00,000 for Rs. 80,000 only, the inadequacy of the price in itself shall not render the transaction void. But where a party pleads coercion or undue influence or fraud, inadequacy of consideration will also be a piece of evidence to be looked into. For example, B agrees to sell a horse worth Rs. 1,000 for Rs. 100, B denies that his consent to the agreement was freely given. The inadequacy of consideration is a fact which the Court should take into account in considering whether or not B's consent was freely given. Section 25 *(Explanation 2) of Indian Contract Act also states that an agreement to which the consent of the party is freely given is not void merely because the consideration is inadequate; but the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promisor was freely given.*

Check Your Progress A

1. What is consideration?

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2. What is quid-pro-quo?

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3. At whose desire should consideration move?

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4. Is past consideration valid?

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5. Can consideration move from a stranger?

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6. Fill in the blanks :

   i) Consideration................move at the desire of.................

   ii) Consideration need not be....................... but it must be of some .... in the eyes of law.

   iii) A contract without consideration is. ....

7. State whether following statements are True or False.

   i) An act constituting consideration must have been done at the desire or request of the promisor or a third party.

   ii) Consideration must result in a benefit to both the parties.

   iii) Past consideration is no consideration.

   iv) Consideration may move from the promisee or any other person.

   v) A stranger to a contract may sue upon it if the contract is for his benefit.

   vi) Consideration must be proportionate to the value of the promise.

   vii) A stranger to consideration can sue.

5.6 LEGALITY OF AGREEMENTS WITHOUT CONSIDERATION

Acording to Section 10 of the Indian Contract Act consideration is an important element for a contract to be valid. Section 25 echoes this view and declares a **contract without consideration as void**. However, it also recognises certain, exceptions. Besides, section 185 also provides for a case where a contract without consideration shall be valid. Thus, the circumstances under which a contract, in spite of no consideration, may be enforceable are stated below:

1. **Agreements in writing and registered**: An agreement made without consideration is valid if it is:

   a) expressed in writing,

   b) registered (under the law for the time being in force for registration of documents),

   c) made on account of natural love and affection, and

   d) between parties standing in a near relation to each other.

   For 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. Held, the agreement was valid (**Venkataswamy v. Rangaswamy)**.

   You should note that for an agreement to be valid under this clause, **the agreement must be the result of natural love and affection**.

Nearness of relation by itself does not necessarily import natural love and affection. Thus, where a Hindu husband by a registered document, after referring to quarrels and disagreements between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence, it was held that the promise was unenforceable **Rajlakhi Devi v. Bhootnath**.

2. **Promise to compensate** – Section 25(2): A promise made without consideration is valid if

   a) it is a promise to compensate (wholly or in part).

   b) the person to be compensated has already done something voluntarily, or has done something which the promisor was legally compellable to do.

   Examples

   1. A finds B's purse and gives it to him. B promises to give Rs. 100 to A. This is a valid contract even though A was not engaged for the purpose by B and therefore, consideration did not move at the desire of B, the promisor.

   2. A supports B's infant son without asking. B promises to pay A's expenses for so doing. Once again, this is a contract.

3. **Promise to pay a debt barred by limitation act—Section 25(3)**: A promise to pay a debt barred by Limitation Act shall be valid without consideration because legally it remains no longer claimable. You should know that a debt becomes barred under the Limitation Act, if the same is not claimed within a period of 3 years. However, a promise to pay a time barred debt (wholly or in part) shall be valid if

   i) the promise is put into writing

   ii) signed by the debtor or his agent, and

   iii) relates to a debt which the creditor might have enforced payment of but for the law of limitation.

   For example, X owes Y Rs. 800, but the debt is time barred. X signs a written promise to pay Rs. 600 on account of the debt. This is a valid contract (Section 25).

4. **Completed gifts**: The rule no consideration, no contract does not apply to completed gifts. These need not be the result of natural love and affection or near relation, but the gifts must be complete. (Explanation 1 to Section 25). Completed gifts mean gifts made and accepted. However a promise to gift is not valid.

5. **Agency**: For creation of an agency, no consideration is required. You should note that, however, if no consideration has passed to the agent, he is only a gratuitous agent and is not bound to do the work entrusted to him, although if he begins the work he must do it to the satisfaction of his principal

(Section 185).

6. **Charity**: If a person promises to contribute to charity and on this faith the promisee undertakes a liability to the extent not exceeding the promised subscription, the contract shall be valid (**Kedarnath v. Gorie Mohammad**).

To sum up, an agreement without consideration shall be valid in the following cases:

1. If the agreement is in writing and registered resulting from natural love and affection between persons in near relationship.

2. If it is a promise to compensate for something voluntarily done for the promisor.

3. If it is a written promise to pay a debt barred by the law of limitation.

4. If it is a promise with regard to completed gifts, i.e., gifts made and accepted by the other.

5. If it relates to creation of an agency.

6. If it is a promise to contribute to charity and with this faith, the promisee undertakes a liability.

5.7 LEGALITY OF OBJECT AND CONSIDERATION

In most of the cases, the words 'Object' and 'Consideration' mean the same thing. But in some cases they may be different. For example, where money is borrowed for the purpose of the marriage of a minor, the consideration for the contract is the loan and the object is the marriage. We have already noted that an agreement will not be enforceable if its object or the consideration is unlawful. According to section 23 of the Act, the consideration and the object of an agreement are unlawful in following cases:

1. **If it is forbidden by law**: If the object or the consideration of an agreement is the doing of an act forbidden by law, the agreement is void. An act or an undertaking is forbidden by law when it is punishable by the criminal law of the country or when it is prohibited by special legislation derived from the legislature.

Examples

i) 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 back (**Srinivas v. Raja Ram Mohan**).

ii) A promises to drop 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 (**Illustration (h) to**

Section 23).

2. **If it defeats the provisions of any law**: If it is of such a nature that if permitted, it would defeat the provisions of any law. In other words if the object or the consideration of an agreement is of such a nature that, though not directly forbidden by law, it would defeat the provisions of the law, the agreement is void. For example, A's estate is sold for arrears of revenue under the provisions of an Act of the Legislature, by which the defaulter is prohibited from purchasing the estate. B, upon the understanding with A, becomes the purchaser and agrees to convey the estate to A for the price which B has paid. The agreement is void as it renders the transaction, in effect, a purchase by the defaulter, and would so defeat the object of the law (**Illustration (i) to Section 23**).

3. **If it is fraudulent**: An agreement with a view to defraud others is void. For example, A, B and C enter into an agreement for the division among them of gains acquired or to be acquired, by them by fraud. The agreement is void as its object is unlawful.

4. If it involves or implies injury to the person or property of another. If the object of an agreement is to injure the person or property of another, it is void. For example, A borrowed Rs. 100 from B. A executed a bond promising to work for B without pay for 2 years and in case of default agreed to pay interest at a very exorbitant rate and the principal amount at once. Held, the contract was void (**Ram Saroop v. Bansi**).

5. **If the Court regards it as immoral or opposed to public policy**: An agreement whose object or consideration is immoral or is opposed to the public policy, is void. For example, A let a cab on hire to B, a prostitute, knowing that it would be used for immoral purposes. The agreement is void **(Pearce v. Brooks).**

Partial Illegality

Section 24 of the Indian contract Act provides that if any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void. For example, A promises to supervise the business on behalf of B, a licensed manufacturer of some permissible chemicals and some contraband items. B promises to pay A a salary of Rs. 10,000 per month. The agreement is void, the object of A's promise and the consideration for B's promise being in part unlawful.

It is well settled that if several distinct promises are made for one and the same lawful consideration, and one or more of them be such as the law will not enforce, that will not of itself prevent the rest from being enforceable. The test is whether a distinct consideration which is wholly lawful can be found for the promise called in question. **According to Justice Wiles, the general rule is that, where you cannot sever the illegal from the legal part of a convenant, the contract is altogether void; but where you can sever them, whether the illegally be created by statute or by the common law, you may reject the bad part and**

retain the good.

Check Your Progress B

1. State whether the following statements are True or False.

   i) A promise to gift is enforceable by the donee.

   ii) A verbal promise to pay a debt barred by the Limitation Act is enforceable.

   iii) A promise to compensate a voluntary act done in the past is valid.

   iv) An agent is bound to do a promised act in spite of no quid pro quo.

   v) An agreement to commit fraud is voidable.

2. A few persons agree to purchase shares of a company in order to induce other persons to believe, contrary to the fact, that there is a *bonafide* market for the shares. Is such an agreement lawful?

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5.8 AGREEMENTS OPPOSED TO PUBLIC POLICY

It is very difficult to define the term 'public policy' with any degree of precision because 'public policy', by its very nature, is highly uncertain and fluctuating. It keeps on varying with the habits and fashions of the day, with the growth of commerce and usage of trade. In England, **Lord Halsbury in case of Janson v. Drieftein Consolidated Mines Ltd**. observed "that categories of public policy are closed, and that no court can invent a new head of public policy." Section 23 of the Indian Contract Act, however, leaves it open to court to hold any contract as unlawful on the ground of being opposed to public policy.

In simple words, it may be said that **an agreement which conflicts with morals of the time and contravenes any established interest of society, it is void as being against public policy**. Thus, an agreement which tends to be injurious to the public or against the public good is void as being opposed to public policy. According to Mulla, "Agreements may offend against the public policy, or tend to the prejudice of the State in time of war (trading with the enemies, etc.), by tending to the perversion or abuse of municipal justice, (stifling prosecution, champerty, maintenance) or in private life by attempting to impose inconvenient and unreasonable restrictions on the free choice of individual in marriage or their liberty to exercise any lawful trading or calling."

Heads of Public Policy

The commonly accepted grounds of public policy include:

1. **Trading with Enemy**: All contracts made with an alien (foreigner) enemy,

unless made with the permission of the Government, are illegal on the ground of public policy.

2. **Agreements for stifling prosecution**: Contracts for compounding or suppressing of criminal charges for offences of a public nature are illegal and void. The Law states "you cannot make a trade of your felony (crime), you cannot convert a crime into a source of profit". It is observed in **Sudhindra Kumar v. Ganesh Chandra,** that no court of law can countenance or give effect to an agreement which attempts to take the administration of law out of the hands of the judges and put it in the hands of private individuals. For example, A knowing that B has as committed a murder, obtains a promise from B to pay him (A) Rs. 1,00,000 in consideration of not exposing B. This is a case of stifling prosecution and the agreement is illegal and void.

3. **Contracts in the nature of champerty and maintenance**: In England agreement of 'maintenance' and 'champerty' are void on the ground of their being opposed to public policy. '**Maintenance' means the promotion of litigation in which a person has no interest of his own**. In other words, where a person agrees to maintain a suit, in which he has no interest, the proceeding is known as Maintenance. Thus, maintenance tends to encourage speculative litigation. **'Champerty' is a bargain whereby one party is to assist another in recovering property and, in turn, is to share in the process of the action. Under English Law**, both of these agreements are declared illegal and void. **Indian Law** is different. In **Raja Venkata Subhadrayamma Guru v. Sree Pusapathi Venkatapathi Raju**, the Privy Council held that champerty and maintenance are not illegal in India, and that Courts will refuse to enforce such agreements only when they are found to be extortionate and unconscionable and not made with the bonafide object of assisting the claims of the person unable to carry on litigation himself. In other words, only those agreements which appear to be made for purposes of gambling in litigation and for injuring or oppressing others, by encouraging unholy litigation, will not be enforced, but not all agreements of champerty or maintenance. Thus, an agreement to render services for the conduct of litigation in consideration of payment of 50 per cent of the amount recovered through Court would be legally enforceable. But, where it was found that the value of the part of the estate promised to be conveyed amounted to Rs. 64,000 in return for Rs. 12,000 which was to be spent by the financier on the prosecution of an appeal in the Privy Council, it was held that although the agreement was bonafide, it could not be enforced, the reward being extortionate and unconscionable.

4. **Agreements for the sale of public offices and titles**: Traffic by way of sale of public offices and appointment obviously tends to the prejudice of the public service by interfering with the selection of the best qualified persons. Such sales are, therefore, unlawful and void.

   1 A promises to pay B Rs. 5,000 if B secures him an employment in the public service. The agreement is void.

   2 Similarly, where A promises to pay a sum to B in order to induce him to retire so as to provide room for A's appointment to the

public office held by B, the agreement is void (**Saminatha v. Muthusami**).

5. **Agreements in restraint of parental rights.** According to law, the father is the guardian of his minor child. After the father, the right of guardianship vests in the mother. This right cannot be bartered away by any agreement. Thus the authority of a father cannot be alienated irrevocably and any agreement purporting to do so is void. For example, a father having two minor sons agreed to transfer their guardianship in favour of Mrs. Annie Besant and also agreed not to revoke the transfer. Subsequently he filed a suit for recovery of the boys and a declaration that he was the rightful guardian, the court held that he had the right to revoke his authority and get back the children (**Giddu Narayanish v. Mrs. Annie Besant**).

6. **Agreements in restraint of marriage**: Under Section 26, every agreement in restraint of the marriage of any person other than a minor is void. (*You will study it in detail in Unit 6*).

7. **Marriage brokerage or brokage contracts**. A marriage brokerage contract is one in which, in consideration of marriage, one or the other of the parties to it, or their parents or third parties receive a certain sum of money. Accordingly, dowry is a marriage brokerage and hence unlawful and void.

   In the case of Venkatakrishna v. Venkatachalam, a sum of money was agreed to be paid to the father in consideration of his giving his daughter in marriage. Held, such a promise amounted to a marriage brokerage contract and was void.

   Similarly, where a purohit was promised a certain sum of money in consideration of procuring a second wife for the defendant, it was held that the promise was opposed to public policy and, thus, void (**Vaithvanathan v. Gangaraju**).

   In the above case, if marriage had been performed and the money remains unpaid, it cannot be recovered in a Court of Law. But, if the money had been paid and marriage also performed, the money cannot be taken back.

8. **Agreements in restraint of legal proceedings**: Section 28 specifies two kinds of agreements as void: (i) 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, and (ii) an agreement which limits the time within which the contractual rights may be enforced. It is discussed in more detail in Unit 6.

9. **Agreements interfering with course of justice**: Any agreement for the purpose or to the effect of using improper influence of any kind with judges or officers of justice is void.

10. **Agreements in restraint of trade**: In India, agreements in restraint of trade, whether the restraint is total or partial, are declared void under Section 27. These have been discussed in detail in Unit 6.

11. **Agreements tending to create monopolies**: Being opposed to public

interest, the contracts tending to create monopolies are void. For example, in **District Board of Jhelum v. Harichand** a local body granted a monopoly to A to sell vegetables in a particular locality. Held, the agreement was void.

12. **Agreement in restraint of personal liberty**: Agreements which unduly restrict the personal freedom of persons are void and illegal being against public policy. For example, X, the debtor, borrowed money from Y, the money lender, on the promise that he would not, without his written consent, leave his job, borrow money, dispose of his property or change his residence. Held, the agreement was void and illegal as it restricted the personal freedom of X (**Harwood V. Miller's Timber and Trading Co.**).

Check Your Progress C

1. A promises to pay his lawyer a fee of Rs. 5,000 if he wins the suit and also promises to transfer to him part of the property in dispute. Can the lawyer recover the promised fee and also claims share in the property?

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2. A promises to pay Rs. 1,000 per month to a married woman B, in consideration of B living in adultery with A and acting as his house-keeper. Can B lawfully recover the amount, if A later refuses to pay her?

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5.9 LET US SUM UP

Consideration (*the quid pro quo*), is an essential element to make a contract valid and enforceable. Consideration to be valid must not only be supplied at the desire of the promisor but also should be real and legal. It need not, however, necessarily be supplied by the promisee or be adequate.

Section 25 which declares a contract without consideration as no contract also recognises certain exceptions whereunder in spite of there being no consideration contract shall be valid and enforceable. Section 185 further adds to the list of these exceptions. Thus, the contracts without consideration are valid in the cases: i) agreements which are the result of natural love and affection between parties standing in a near relationship, if the agreement is written and registered, ii) a promise to compensate for something voluntarily, iii) a promise to pay a time-barred debt, iv) completed gifts (i.e., gifts offered and accepted) are valid, but a promise to gift cannot be enforced, v) contracts of agency, vi) Charity.

The consideration or object of a contract shall be unlawful where: i) it is forbidden by law, ii) if permitted would defeat the provisions of any law, iii) it is fraudulent, iv) it involves or implies injury to the person or property of another, and v) the court regards it as immoral, or opposed to public policy.

What agreements shall be construed against public policy are not defined anywhere in the Act. On analysis of judicial pronouncements, such agreements may be said to include: (I) trading with enemy, (2) agreements for stifling prosecution, (3) champerty and maintenance contracts, (4) agreements for sale of public offices and titles, (5) agreements in restraint of parental rights, (6) marriage brokerage or brokage contracts, (7) agreements interfering with course of justice, (8) agreements to create monopolies, (9) agreement in restraint of trade. (10) agreements in restraint of marriage, (11) agreement in restraint of personal liberty, and (12) agreement in restraint of legal proceedings.

5.10 KEY WORDS

Detriment: It connotes a meaning similar to loss. In particular, it means damage or injury to one's interest.

Maintenance and Champerty: These two expressions are normally used together in law. 'Maintenance' means the promotion of litigation in which a person has no interest of his own. 'Champerty', on the other hand, is a bargain whereby one party is to assist another in recovering property and in turn is to share in the proceeds of the action.

Quid-pro-quo: This latin expression means 'something in return'.

Stifling Prosecution: Withholding information which may lead to the prosecution of another. The intention is to make a personal gain/ bargain.

Stranger to Consideration: A person who is a party to the contract but has not supplied the consideration himself. Instead, the consideration is supplied for him by some other person.

Stranger to Contract: A person who is not a party to the contract.

5.11 ANSWERS TO CHECK YOUR PROGRESS

A) 1. Consideration is the price for which the promise of the other is bought.

2. 'Quid-pro-quo' is a latin expression means 'something in return'

3. The promisor

4. Yes

5. Yes

6. i) must, the promisor

ii) adequate, value

iii) void-ab-initio-(nudum pactum)

7. i) False ii) False iii) False iv) True v) True vi) False vii) True

B) 1. i) False ii) False iii) True iv)True v) False

2. No. Section 23, unlawful object. Involves injury to the person or

property of another. Similar decision was given in Gherulal Parekh v. Mahadeo.

C) 1. Lawyer can recover the promised fee but not share in the property. Read the discussion on Champerty and Maintenance.

2. No, the agreement being for an immoral act is against public policy and thus void (Section 23).

5.12 TERMINAL QUESTIONS

1. Define 'Consideration'. Discuss various types of consideration.
2. Do you agree with the view 'No Consideration, No Contract?
3. In what cases a contract without consideration is not valid?
4. Discuss the rule that a stranger to a contract cannot sue on the contract. Are there any exceptions to this rule?
5. 'A stranger to contract cannot sue, but a stranger to consideration can sue'. Do you agree?
6. "Insufficiency of consideration is immaterial, but a valid contract must be supported by lawful and real consideration." Comment.
7. Under what circumstances is the object or consideration of a contract deemed unlawful? Illustrate.
8. Discuss the doctrine of public policy. Give examples of agreements that are considered opposed to public policy.

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Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

UNIT 6 VOID AGREEMENTS AND CONTINGENT CONTRACTS

Structure

6.0 Objectives

6.1 Introduction

6.2 Void Agreements

- 6.2.1 Agreements in Restraint of Marriage
- 6.2.2 Agreements in Restraint of Trade
- 6.2.3 Agreements in Restraint of Legal Proceedings
- 6.2.4 Uncertain Agreements
- 6.2.5 Wagering Agreements
- 6.2.6 Agreements to do Impossible Acts
- 6.2.7 Restitution

6.3 Contingent Contracts

- 6.3.1 What is a Contingent Contract?
- 6.3.2 Rules Regarding Enforcement of Contingent Contracts
- 6.3.3 Difference Between a Contingent Contract and a Wagering Agreement

6.4 Let Us Sum Up

6.5 Key Words

6.6 Answers to Check Your Progress

6.7 Terminal Questions

6.0 OBJECTIVES

After studying this unit, you should be able to :

- describe and identify agreements which are void-ab-initio or become void subsequently;
- explain the status of agreements in restraint of marriage, trade and legal proceedings;
- describe uncertain agreements and state whether such agreements shall be valid or not;
- define wagering agreements, state their legal status and distinguish between such agreements and other similar contracts;
- state the effect of 'impossibility' on contracts and their legal status; and
- explain the contingent contracts.

6.1 INTRODUCTION

You have already learnt about the term 'void agreement'. In this unit you will study about the various agreements which have been specifically declared void and the agreements which (on the face of it) appear to be void but are not treated

as such. This unit also includes detailed discussion on contingent contracts.

6.2 VOID AGREEMENTS

Section 2(g) of the Indian Contract Act defined a void agreement as, "an agreement not enforceable by law". Some agreements are void-ab-initio which means that they are unenforceable right from the time they are made. For example, you learnt that an agreement with a minor or a person of unsound mind is void-ab-initio. Such a agreement does not become a contract at all. There may, however, be some agreement which, when made, are enforceable (i.e., they are contracts) but later, due to development of certain circumstances or change in circumstances, the contracts becomes unenforceable. When they become unenforceable they are called 'void contracts'. For example, A agrees to sell B a ship load of sugar on its way from Cuba, to India. Due to heavy storm, the sea water enters the ship and the whole sugar gets wet. This makes the contract void as A cannot compel B to accept wet sugar in place of sugar saying it is the same sugar, only its form having changed. So also B cannot insist A to deliver him the agreed sugar or else pay damages. Then, there are certain agreements which have been expressly declared void under certain provisions of the contract Act or any other law.

The following types of agreements have expressly been declared void under various sections of the Indian Contract Act.

1. Agreements by or with persons incompetent to contract (sections 10 & 11)
2. Agreements entered into through a mutual mistake of fact between the parties (section 20)
3. Agreements, the object or consideration of which is unlawful (section 23)
4. Agreement, the consideration or object of which is partly unlawful (section 24)
5. Agreements made without consideration (section 25)
6. Agreements in restraint of marriage (section 26)
7. Agreements in restraint of trade (section 27)
8. Agreements in restraint of legal proceedings (section 29)
9. Uncertain agreements
10. Wagering agreements (section 30)
11. Impossible agreements (section 56)

In Units 3 to 5 you have already read about agreements in items 1 to 5 listed above. We shall, now study the rest of the 'void agreements' i.e., items 6 to 11.

6.2.1 Agreements in Restraint of Marriage

According to section 26 of the Indian Contract Act, every agreement in restraint of the marriage of any person, other than a minor, is void. The restraint may be general or partial. Thus the party may be restrained from marrying at all, or from marrying for a fixed period, or from marrying a particular person, or a class of persons. For example, A promised to marry none else except B, and in default pay her a sum of Rs. 2,000. A married some one else and B sued A for recovery of Rs. 2,000. Held, the agreement was in restraint of marriage and as such void (**Lowe v. Peers**).

However, **a penalty upon remarriage may not be construed as a restraint of marriage**. Thus, an agreement between two co-widows that if one of them remarried she should forfeit her right to her share in the deceased husband's property, has been upheld (**Rao Rani v. Gulab Rani**).Similarly, a provision in Nikah Nama (marriage agreement) by which a Muslim husband authorises his wife to divorce herself from him in the event of his remarrying a second wife is not void. Thus, if the wife divorces herself from the husband on his marrying a second wife, the divorce shall be valid, and she will be entitled to mintenance from him **(Badu v. Badaranessa).**

6.2.2 Agreements in Restraint of Trade

Freedom of trade and commerce is a fundamental right protected by Article 19(g) of the Constitution of India. Just as the Legislature cannot take away individual freedom of trade, so also the individual cannot barter it away by an agreement. As per Justice James, V.C., "public policy requires that every man shall be at liberty to work for himself, and shall not be at liberty to deprive himself or the state of his labour, skill or talent, by any contract that he enters into". **Courts, therefore, do not allow any tendency to impose restrictions upon the liberty of an individual to carry on any business, profession or trade**.

In India, the law on the subject is contained in section 27 which reads: Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void. Thus, all agreements in restraint of trade, whether general or partial, qualified or unqualified, are void.

Examples

1. In Patna city 29 out of 30 manufacturers of combs agreed with R to supply him combs and not to anyone else. Under the agreement R was free to reject the goods if he found there was no market for them. Held, the agreement amounted to restraint of trade and was thus void (**Sheikh Kalu v. Ramasaran Bhagat**).

2. J, an employee of a company, agreed not to employ himself in a similar business within a distance of 800 miles from Madras after leaving the company's service. *Held*, the agreement was void (**Oakes & co. v. Jackson**).

3. A and B carried on similar business in a certain locality in Calcutta. A promised to stop business in that locality if B paid him Rs. 900 which he had paid to his workmen as advance. A stopped his business but B did not pay him the promised money. Held, the agreement was void and, therefore, nothing could he recovered on it (**Madhab v. Raj Coomar**).

Exceptions

There are two exceptions to this rule: 1) those created by statutes, and 2) those arising from judicial interpretations of section 27.

Statutory Exceptions: Following are the exceptions created by the statutes:

1. **Sale of Goodwill**: The seller of goodwill of a business may agree with the buyer thereof not to carry on a similar business within specified local limits. Such a restraint shall be valid, if limits are reasonable (section 27). Please note that the reasonableness of restrictions will depend upon many factors, such as the area in which the goodwill is effectively enjoyed, the price paid

for it and above all, the nature of the business. For example, a seller of immitation jewellery in England, sold his business to B and promised that for a period of two years he would not deal (a) in immitation jewellery in England (b) in real jewellery in certain foreign countries. The first promise alone was held lawful. The second promise is void and the restraint was unreasonable in point of space and nature of business (**Goldsoll v. Goldman**).

2. **Certain restraints in partnership**: There are four provisions under the Partnership Act which recognise agreements in restraint of trade as valid. Accordingly, partners may agree that:

   a) A partner shall not carry on any business other than that of the firm while he is a partner [section 1l(2) of the Indian Partnership Act, 1932].

   b) A partner on ceasing to be a partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. The agreement shall be valid only if the restrictions are reasonable [section 36(2) of the Indian Partnership Act, 1932].

   c) Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be valid provided the restrictions imposed are reasonable (section 54 of the Indian Partnership Act, 1932).

   d) A partner may, upon the sale of the goodwill of, a firm, make an agreement that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. Any such agreement shall be valid if the restrictions imposed are reasonable [section 55(3) of the Indian Partnership Act, 1932].

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Exceptions

Under Judicial Interpretations: Following are the exceptions arising under Judicial interpretation of section 27 of Indian Contract Act.

1. **Trade Combinations**: Business combinations with the idea of regulating business and not restraining it have been held to be desirable in public interest. Restraints imposed by such associations are, therefore, not to be declared void on grounds of restraint of trade. In the case of **Haribhai v. Sharef Ali**, four ginning factories entered into an agreement fixing uniform rate for ginning cotton and pooling their earnings to be divided between them in certain proportions. The Bombay High Court held the agreement to be valid and enforceable. But the Courts would not allow a restraint to be imposed disguised as trade regulations. Thus, an agreement between certain persons to carry on business with the members of their caste only (**Vaithelinga v. Saminada**), and an agreement to restrict the business of sugar mill within a zone allotted to it, have been held void (**Carew & Co. Ltd. v. North Bengal Sugar Mills**).

2. **Exclusive Dealing Agreements**: Reasonable agreements to deal in the products of a single manufacturer or to sell the whole produce to a single dealer have been upheld to be valid and not in restraint of trade. Thus, the following agreements were upheld as enforceable:

   i) An agreement by a manufacturer of dhotis to supply 1,36,000 pairs of certain description to the defendent and not to sell goods of that kind to any other person for a fixed period (**Carlies Nephew & Co. v. Ricknauth Buckter mull**).

ii) An agreement by a person to sell all the salt manufactured by him to a firm for five years (**Mackenzie v. Sriramiah**).

iii) An agreement by a person to sell all the mica produced by him to the plaintiffs, and not to any other firm nor to keep any in stock (**Subha Nuidu v. Haji Badshah Sahb**).

iv) An agreement by a buyer of goods for Calcutta market, not to sell them in Madras .

However, where a manufacturer or supplier, after meeting all the requirements of a buyer, has surplus to sell to others, he cannot be restrained from doing so (**Shaikh Kalu v. Ram Saran Bhagat**). Similarly, exclusive dealing agreements shall not be valid if their terms are unreasonable or they unreasonably check competition (**Esso Petroleum Co. v. Harper's Garage Ltd**.).

3. **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 (**Charles Worth v. Macdonald**). For example, A agreed to become assistant for three years to B who was a doctor practising at Zanzibar. It was agreed that during the term of the agreement A was not to practise on his own account in Zanzibar. After one year, A started his own practice. Held, the agreement was valid and A could be restrained by an injunction from doing so.

These days it is a common practice to appoint trainees. A service bond is normally got signed whereby the trainee agrees to serve the organisation for a stipulated period. Such agreements, if reasonable, do not amount to restraint of trade and hence are enforceable. But an agreement to restrain an employee from competing with his employer after the termination of his employment may not be allowed by the courts. Thus, in the case of **Brahamputra Tea Co v. E. Scarth**, where an attempt was made to restrain a servant from competing with his employer for 5 years after the period of service, the court disallowed it.

Check Your Progress A

1. Are the following agreements valid?

a) A sells the goodwill of his business in South Delhi to B and agrees with him not to carry on a similar business within the boundaries of South Delhi.

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b) X, an optical surgeon, employs Y as his assistant for a term of 3 years and Y agrees not to practise as a surgeon during this period.

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c) A, a shopkeeper of Hauz Khas Market, agrees to pay B, his rival in business, a sum of money as compensation if B closes his business there.

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2. N sold his business and goodwill by an agreement. The agreement provided that the company: (i) not to practise the same trade for 25 years, and (ii) not to engage in any business competing or liable to compete in any way with the business that the company may engage itself in.

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3. A and B were rival shopkeepers in the same locality. A agreed to pay B a certain sum of money if B closes his business in that locality. B accordingly did so, but A refused to pay. Can B claim the promised amount.

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4. A, a doctor in Delhi, employed another doctor B, as an assistant for a period of three years on a salary of Rs. 1,000 per month. The agreement between A and B provided that after termination of his employment B shall not practise as a doctor in Delhi within a radius of one mile of A's dispensary for a period of one year, and if B did so, B should pay Rs. 10,000 to A as liquidated damages. Immediately after the termination of his employment B begins to practise as a doctor next door to A's dispensary. Shall A succeed if he sue B for the recovery of Rs. 10,000?

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6.2.3 Agreements in Restraint of Legal Proceedings

Section 28 of the Indian Contract Act, as amended by Indian contract (amendment) Act, 1996 regards the following two restraints of legal proceedings as void.

1. **Restriction on Legal Proceedings**: An agreement by which a party is restricted absolutely from enforcing his legal rights under, or in respect of, any contract by the usual legal proceedings in the ordinary tribunals. For 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. But, a contract whereby it is provided that all disputes arising between the parties should be referred to the arbitration, whose decision shall be accepted as final and binding on both parties of the contract, is not invalid. The courts have power, in spite of such a stipulation, to set aside the decision of the arbitrator on grounds of misconduct on the part of the arbitrator.

   A contract may contain a double stipulation that any dispute between the parties should be settled by arbitration, and neither party should enforce his

rights under it in a court of law. Such stipulation would be valid as regards its first branch. i.e., all disputes between the parties should be referred to arbitration, because that stipulation itself would not have the effect of ousting the jurisdiction of the courts. But the latter branch of the stipulation (i.e, neither party should enforce his rights under it in a court of law) would be void because by that the jurisdiction of the court would be necessarily excluded. Further, it should be noted that 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 section 28 (**Milton & Co. v. Ojha Automobile Co.**).

2. **Limitation of Time:** Another type of agreement rendered void by section 28 is where 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 law of limitation. For example, according to the Indian Limitation Act, an action for breach of contract may be brought within three years from the date of breach. If a clause in an agreement provides that no action should be brought after two years, the clause is void.

   A clause in a policy of life insurance declaring that "no suit to recover under this policy shall be brought after one year from the death of the assured" was held void. However, cases of the above sort are distinguished from those which provide for surrender or forfeiture of rights if no action is brought within the stipulated time. A clause in a policy of life insurance provided "if a claim be made and rejected and an action or suit be not commenced within three months after such rejection ..., all benefits under the policy shall be forfeited." This clause was held valid.

6.2.4 Uncertain Agreements

An agreement is called an uncertain agreement when the meaning of that agreement is not certain or capable of being made certain. Such agreements are declared void under section 29.

Examples

1. A agrees to sell to B "one hundred tons of oil". The agreement is void for uncertainty since there is no clearity in the agreement what kind of oil was intended.

2. A agrees to sell B "my white horse for Rs. 5,000 or Rs. 10,000". There being nothing to show which of the two prices was to be given, the agreement is void.

In the case of **Guthing v. Lynn**, a horse was bought for a certain price coupled with a promise to give £5 more if the horse proved lucky. The agreement was held void for uncertainty. The Court had no machinery to determine what luck the horse had brought to the buyer.

Cases relating to uncertain agreements have generally arisen in connection with the sale of goods where uncertainty is related to the price. For example, where goods are sold, the price being payable subject to 'hire-purchase' terms

(**Scammell v. Ouston**) or at such price as should be agreed upon between the parties (**May & Butcher v. The King),** the agreement in each case was held void for uncertainty as to price. However, you should note that where the price is left to be fixed by a third party, there is no uncertainty and the agreement will be enforceabe. For example, where A agrees to sell to B one thousand kilograms of rice at a price to be fixed by C, there is no uncertainty as the price is capable of being made certain. The agreement, therefore, is not rendered void. Similarly, if the agreement is totally silent as to price, it will be valid, as in that case, section 2 of the Sale of Goods Act will apply and the reasonable price shall be payable.

Certain other illustrations where agreements have been declared void for uncertainty:

1. An agreement to grant a lease when no date of commencement is expressly or impliedly fixed (**Giribala Dasi v. Kalidas Bhanga**). But when the commencement of a lease, is dependent upon a contingency, which has occurred, the agreement is not void (**Sitlani v. Viroosing**).

2 An agreement to pay a certain amount, after deductions as would be agreed upon between parties (**Kalpana Devara v. Krishna Mitter**).

3. A contract to negotiate (**Courtney and Fairbaion Ltd. v. Tolani Bors. (Hotels Ltd.)**

4. A defendant passed a document to the Agra Savings Bank whereby he promised to pay to the manager of the bank the sum of Rs. 10 on or before a certain date and a similar sum monthly every succeeding month. It was held that the instrument could not be regarded as a promissory note as it was impossible from its language to say for what period it was to continue and what amount was to be paid under it (**Carter v. The Agra Savings Bank**).

Certain illustrations where agreements have been held not to be uncertain:

1. A, who is a dealer in coconut oil only, agrees to sell to B "one hundred tons of oil". The nature of A's trade indicates the meaning of the words, and A has entered into a contract for the sale of one hundred tons of coconut oil.

2. A agrees to sell B "all the grain in my granary at Ramnagar". There is no uncertainty here to make the agreement void.

3. A agrees to sell B one hundred tons of coconut oil at a price to be fixed by C, As the price is capable of being made certain, there is no uncertainty here to make the agreement void.

6.2.5 Wagering Agreements

The Indian Contract Act does not define a wager. A wagering agreement, according to Sir William Anson, *is a promise to give money or money's worth upon the determination or ascertainment 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 of no 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.** For example, A and B bet as to whether it would rain on a particular day or not. A promising to pay Rs. 100 to B if it rained, and B promising an equal amount to A, if it did not. This agreement is a wager.

Essentials of a Wagering Agreement: From the above description of a wagering agreement, following essentials may be noted.

1. **Uncertain event**: The first thing essential to wager is that the performance of the bargain must depend upon the determination of an uncertain event. An event may be uncertain either because it is yet to take place or it might have already happened but the parties are not aware of its result.

2. **Mutual chances of gain or loss**: The second essential feature is that upon the determination of the contemplated event each party should stand to win or lose. If either of the parties may win but cannot lose, it is not a wagering agreement.

3. **Neither party to have control over the event**: Neither party should have control over the happening of the event one way or the other. If one of the parties has the event in his own hands, the transaction lacks an essential ingredient of a wager.

4. **No other interest in the event**: Further, neither party should have interest in the happening of the event other than the sum or stake he will win or lose.

5. **Promise to pay money or money's worth**: Lastly, to constitute wager, the promise should be to pay money or money's worth only.

Effects of Wagering Agreement: An agreement by way of wager is void. Section 30 provides: *agreements by way of wager are void; and no suit shall be brought for recovering anything alleged to be won on any wager or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made.* Thus, in India, unless the wager amounts to a lottery (it is a crime according to section 294-A of the Indian Penal Code), it is not illegal but simply void. For example, A borrows Rs. 500 from B to pay to C, to whom A has lost a bet. Agreement between A and B is valid. You should note that a collated transaction of wager is not void and are valid and enforceable as in the case of the example. It should be noted that in Maharashtra and Gujarat they have been declared illegal, hence make all the collateral transactions void.

Lotteries: Lottery is an arrangement for the distribution by chance among persons purchasing tickets. The dominant motive of the participants need not be gambling. Where, however, a wagering transaction amounts to a lottery, it is illegal and comes under section 294-A of the Indian Penal Code. This section reads as follows:

Whoever keeps any office or place for the purpose of drawing any lottery not authorised by Government, shall be punished with imprisonment of either description for a term which may extend to six months, or with fine or with both.

And whoever published any proposal to pay any sum or to deliver goods, or to do or forbear doing any-thing for the benefit of an person, on any event or contingency relative or applicable to the drawing of any ticker, lot number of figure in any such lottery, shall be punished with fine which may extend to one thousand rupees.

In the case of Universal Mutual Aid and Poor Houses Association v. Thoppa Naidu, monthly subscriptions were collected to raise a donation fund to carry out charitable objects. A substantial portion of the interest accruing on the fund so raised was utilised in granting loans free of interest and cash bonuses to certain subscribers, the names and amounts to be determined by means of drawings. The court held that the business carried on by the company was a lottery and therefore illegal, though there was a charitable or philanthropic purpose annexed to the lottery. The company was, therefore, ordered to be wound up.

A cycle and gramophone dealer started a chit with 100 subscribers, each subscribing Rs.3 per month, for a period of 20 months. There was to be a monthly draw in which the subscriber whose number or name drawn was given a cycle or a gramophone at his option and relieved from further liability to pay subscriptions. In the 21st month each of the subscribers who did not draw at any of the previous drawings were given a cycle or gramophone, it was held that the transaction amounted to a lottery and was, therefore, illegal (**Public Prosecutor v. M. Naidu**).

Does the permission from the Government to hold lottery make it legal? In the case of **Sir Dorabji Tata v. Edward F. Lance**, where the Government of India had sanctioned a lottery called the War Loan Lottery, the plaintiff sued on a contract to purchase a ticket bearing a particular number, and for an injunction restraining the Secretary of the Turf Club from proceeding with the drawing. The defence was that, it being a wagering contract, the suit was not maintainable. The court held that the permission granted by the Government will not have the effect of overriding section 30 of the Indian Contract Act and making such a lottery legal. Its only effect was that the person responsible for running the lottery would not be punishable under the Indian Penal Code.

Is purchasing a lottery ticket an offence? It is not an offence to buy a lottery ticket. Section 294-A of the Indian Penal Code is aimed at promoters of lotteries (**Barclay v. Pearson**). In one of the judgments, Supreme Court held that sale of a lottery ticket confers on the purchaser thereof two rights: (a) a right to participate in the draw, and (b) a right to claim a prize contingent upon his being successful in the draw (**H. Anraj v. Government of Tamil Nadu**). Thus this decision of the Supreme Court, by recognising the right of the purchaser of a lottery ticket has reversed the earlier outlook on the subject. It may well be said that where a lottery is authorised by the Government, it shall not be illegal as was decided in the case of **Sir Dorabji Tata v. Edward F. Lance**. Consequently, collateral transactions shall also be enforceable. Thus, where A lends Rs. 2,000 to B for purchase of lottery tickets, A shall be able to recover the same.

Exceptions to Wagering Agreements (Transactions Held 'Not Wagers'): The following transactions have been held not to be wagers:

1. Transactions for the sale and purchase of stocks and shares or for the sale and, delivery of goods, with a clear intention to give and take delivery of shares or goods, as the case may be. You should note that, where the intention is only to settle in price differences, the transaction is a wager and hence void.

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

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

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

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

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

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

6.2.6 Agreements to do Impossible Acts

Section 56 of the Indian Contract Act declares that an agreement to do an act impossible in itself is void. Thus, where A agrees with B to discover treasure by magic, the agreement is void. We may say that parties who purport to agree to the doing of something obviously impossible must be deemed not to be serious or not to understand what they are doing. Moreover, law cannot regard a promise to do something obviously impossible as of any value and such a promise is, therefore, has no consideration.

An agreement to do an act impossible in itself should be contrasted from a contract which becomes impossible of performance. Subsequent impossibility renders a contract void when the act becomes impossible. Details on subsequent impossibility and its effect shall be discussed in Unit 7.

6.2.7 Restitution

Restitution means "return" or "restoration". When an agreement or a contract becomes void, the person who has received any benefit or advantage under such agreement or contract must restore it or compensate for it to the person from whom he has received it (section 65).

Examples

1. A pays B Rs. 1,000 in consideration of B's promising to marry C, who is A's daughter, C is dead at the time of the promise. The agreement is void. B must repay Rs. 1,000 to A.

2. A contracts with B to deliver to him 250 quintals of rice before the first of May. A delivers 130 quintals only before that day and none after. B retains 130 quintals after the first of May. B is bound to pay A for 130 quintals.

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

4. In the above example, if A receives an advance of Rs. 1,000 and is unable to sing due to illness, A must return the advance. B cannot sue A for the loss he has suffered due to A's illness.

It must be noted that the law of restitution is applicable only to those contracts which become void later on by some event which the promiser could not prevent or because of supervening impossibility. The principle of restitution does not apply to the contracts which are void-ab-initio with the exception where the minor has entered into agreement by misrepresenting his age.

6.3 CONTINGENT CONTRACTS

6.3.1 What is a Contingent Contract?

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 (section 31). For example, A contracts to pay B Rs. 10,000 if B's house is burnt. This is a contingent contract.

The following are the essential features of a contingent contract.

1. The performance of a contingent contract is made dependent upon the happening or non-happening of some event.

2. The event on which the performance is made to depend, is **an event collateral to the contract** i.e., it does not form part of the reciprocal promises which constitute the contract. For example, where A agrees to deliver 100 bags of wheat and B agrees to pay the price only afterwards, the contract is a conditional contract and not contingent, because the event on which B's obligation is made to depend is a part of the promise itself and not a collateral event. Similarly, where A promises to pay B Rs. 10,000 if he marries C, it is not a contingent contract.

3. The contingent event should not be the mere will of the promisor. For instance, if A promises to pay B Rs. 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. For example, if A promises to pay B Rs. 1,000 if A left Delhi for Mumbai, it is a contingent contract, because going to Mumbai is an event no doubt within A's will, but is not merely his will.

6.3.2 Rules Regarding Enforcement of Contingent Contracts

The rules regarding contingent contracts are summarised hereunder (sections 32 to 36):

1. Contracts contingent upon the happening of a future uncertain event cannot be enforced by law unless and until that event has happened. And if, the event becomes impossible, such contract becomes void (section 32).

   Examples

   i) A makes a contract with B to buy B's horse if A survives C. This contract cannot be enforced by law unless and until C dies in A's life-time.

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

2. Contracts contingent upon the non-happening of a certain future event can be enforced when the happening of that event becomes impossible, and not before (section 33). For example, A agrees to pay B a sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

3. If a contract is contingent upon as to how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything, which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies (section 34). For example, A agrees to pay B a sum of money if B marries C. But C marries D. The marriage of B to C must now be considered impossible, although it is possible that D may die and then C may afterwards marry B.

4. Contracts contingent upon the happening of an uncertain specified event within a fixed time become void if, at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible (section 35). For example, A promises to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

5. Contracts contingent upon the non-happening of a specified event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened, or before the time fixed expired, if it becomes certain that such event will not happen (section 35). For example, A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

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

Examples

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

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

6.3.3 Difference Between a Contingent Contract and a Wagering Agreement

1. A wagering agreement consists of reciprocal promises while a contingent contract may not consist of reciprocal promises.

2. A wagering agreement is of a contingent nature while a contingent contract may not be of a wagering nature.

3. A wagering agreement is void while a contingent contract is valid.

4. In a wagering agreement parties have no other interest in the subject matter except for winning or losing of wagering amount while it is not so in contingent contracts.

5. In a wagering agreement the future event is the sole determining factor while in a contingent contract future event is only collateral.

Check Your Progress B

1. Are the following contracts valid and enforceable by law?

   i) A contracts to pay B Rs. 10,000 if B's house is burnt.

   ....

   ....

   ....

   ii) A contracts with B to buy B's horse if A survives C.

   ....

   ....

   ....

   iii) A agrees to pay B Rs, 10,000, if he makes two parallel lines meet.

   ....

   ....

   ....

2. M lost a sum of Rs. 8,500 to L & Co. on bets on horse races and his failure to pay was reported to the organising club. M subsequently executed in favour of L & Co, a hundi for Rs. 8,500 in consideration of their withdrawing

his name from the club and thereby preventing his being posted as a defaulter. When L & Co. demanded payment, M pleaded that the consideration was unlawful decide.

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6.4 LET US SUM UP

Void agreements are those agreements which are not enforceable by law. These are agreements in restraint of marriage, agreements in restraint of trade, agreements in restraint of legal proceeding, agreements which are uncertain in their meaning and wagering agreements. In all the aforesaid cases, law declares such agreements to be of no legal effect except in certain exceptional circumstances.

A wagering agreement is a agreement to pay money or money's worth on the happening or non-happening of a specified uncertain event. Wagering agreements are void in India. However in Maharashtra and Gujarat they are illegal.

Contingent contracts are a class of conditional contracts. It is a contract to do or not to do something if some event, collateral to such contract, does or does not happen.

The chief characteristic of Contingent Contracts is that their performance depends upon happening or non-happening of certain event in future and such event must be uncertain and collateral to the contract.

6.5 KEY WORDS

Against Public Policy: Against the general interest of the public.

Collateral Transaction: A transaction which is helping or subsidiary to the main transaction.

Exclusive Dealing Agreements: An agreement to deal exclusively in the products of a single manufacturer or an agreement to sell the whole to a single dealer.

Insurable Interest: A person is so situated with regard to the thing insured that he would have benefit by its existence and loss from its destruction.

Prima Facie: Latin expression which means 'on the face of it'.

Tribunals: Courts and other judicial machinery.

6.6 ANSWERS TO CHECK YOUR PROGRESS

A) 1. a)Yes b) Yes c) No, restraint of trade.

2. The first part of the agreement is valid being reasonably necessary for the protection of the purchaser's interest. But the second part by which he was prohibited from competing with the company in any business which the company might carry on was unreasonable and thus void **(Nordenfelt v. Maxim Nordenfelt Gun Co.)**.

3. No, the agreement being in restraint of trade is void **(Madhab Chander v. Raj Coomar)**.

4. A shall not succeed. Any restraint of trade operative after the termination of employment is bad in law **(Oakes & Co. v. Jackson)**.

B) 1. a) Yes. It is a contingent contract

b) Yes. Again it is a contingent contract but can be enforced only if A survives C.

c) No. Agreement is void (Sections 36 and Section 56).

2. M shall be liable to pay the consideration in the form of L & Co's promise to withdraw. M's name from the club in order to prevent M being posted as a defaulter was legal. A wagering contract being only void does not affect collateral transactions.
(Leicester & Co. v. S.P. Millick)

6.7 TERMINAL QUESTIONS

1. "An agreement in restraint of trade is void". Examine this statement mentioning exceptions, if any.

2 Discuss the law regarding wagering agreements under the Indian Contract Act.

3. A promises to marry B only and none else and in the event of breach agrees to pay Rs. 50,000. A marries C, can B claim Rs. 50,000?

4. What are contingent contracts? State the rules regarding enforcement of such contracts. Give illustrations.

Note: These questions and exercises will help you t o understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

UNIT 7 PERFORMANCE AND DISCHARGE

Structure

7.0 Objectives

7.1 Introduction

7.2 Meaning of Performance
- 7.2.1 Types of Performance
- 7.2.2 Kinds of Tender
- 7.2.3 Essentials of a Valid Tender
- 7.2.4 Effect of Refusal to Perform Promise Wholly

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7.7 Performance of Reciprocal Promises
- 7.7.1 Types of Reciprocal Promises
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7.11 Let Us Sum Up

7.12 Key Words

7.13 Answers to Check Your Progress

7.14 Terminal Questions

7.0 OBJECTIVES

After studying this unit, you should be able to:

- understand the meaning of performance;
- explain the types or performance;
- state the requisites of a valid tender;
- answer the question as to who should perform;

- explain the rules regarding performance of joint promises;
- enumerate the rules relating to time, place and manner of performance; and
- list the various modes of discharge of a contract.

7.1 INTRODUCTION

You have learnt the rules regarding the formation of a contract. After the formation of the contract the logical thing for parties is to perform their respective promises. When the parties to the contract perform the respective obligations, the contract comes to an end. In this unit you will learn about the meaning of performance, types of performance, performance of joint promises, the time, place and manner of performance.

You will also learn about the rules regarding performance of reciprocal promises, assignment of contracts and appropriation of payments. Besides these, different modes of discharge of contract shall also be explained.

7.2 MEANING OF PERFORMANCE

You have learnt that every valid contract creates legal obligation on both the contracting parties and this obligation continues till the contract has been actually performed or otherwise discharged. Performances of the contract is one of the various modes of discharge of the contract and this is the most natural, desired and usual mode of discharging an obligation.

The term 'performance' means that the parties to the contract have fulfilled or carried out their respective obligations arising out of the contract. For example, A contracts to sell his book to B for Rs. 50. A delivers the book and B makes the payment, the contract is discharged by performance.

Section 37 of the Indian Contract Act lays down the obligations of the parties regarding performance. It provides that, *the parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provision of this Act, or any other law.*

7.2.1 Types of Performance

From Section 37 you can infer that the performance may be either actual or attempted. Let us study them in detail.

1. **Actual performance**: When a party to a contract has done, what he had undertaken to do and there remains nothing to be done by him the promise is said to have been actually performed and the liability of such a party comes to an end. For example, A, who is indebted to B for Rs. 1,000, promises to repay the amount after two months. A repays the amount on the due date. This is actual performance.

2. **Attempted Performance**: Sometimes, when the performance becomes due, the promisor offers to perform his obligation but the promisee refuses to accept the performance. This is known as 'attempted performance' or 'tender'. For example, A promises to deliver certain goods to B. A takes the goods to the appointed place during business hours but B refuses to take

the delivery of goods. Thus, A has done what he was required to do under the contract. It is an attempted performance. In case of an attempted performance, the promisor shall not be held liable for non-performance as an attempted performance or tender is as good as performing the contract. Section 38 of the Contract Act provides *where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non performance, nor does he thereby lose his rights under the contract.*

7.2.2 Kinds of Tender

Tender or attempted performance can be of two types (i) tender of goods and services and (ii) tender of money.

i) **Tender of goods and services**: A contract to deliver goods or render some service is completely discharged when the goods are tendered for acceptance according to the terms of the contract. If the goods or services are refused, they need not be offered again and the promisor is discharged from his liability. At the same time, he may file a suit against the promisee for non-acceptance.

ii) **Tender of money**: Where the debtor (promisor) makes a valid tender i.e., offers to pay the amount to the creditor and the creditor refuses to accept the same, the debtor is not discharged from his liability to pay the amount. In other words, a tender of money does not amount to discharge of the debt. The debtor continues to be liable for the payment of debt. But, the debtor will not be liable for interest from the date of a valid tender i.e., no interest shall become payable from the date of the rejection of a valid tender of money.

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7.2.3 Essentials of a Valid Tender

In the foregoing paragraphs you have seen that a tender of performance discharges a party from further liability. However, it is necessary that the tender must be valid. For a tender to be valid, the following conditions must be satisfied:

i) **It must be unconditional**: An unconditional tender is one which is in accordance with the terms of the contract. Thus, a conditional offer of performance is not a good tender and the other party is entitled to reject it. For example, A, a debtor, offered to pay B, his creditor, the amount due to him if B sells certain goods to him. It is a conditional tender and therefore, invalid.

ii) **It must be made at a proper time and place**: Generally, the time and place of performance are agreed upon by the parties and the tender must be made accordingly. Thus, a tender of goods after the business hours or of goods or money before the due date is not a valid tender. For example, if the promisor wants to deliver the goods at 1 a.m., this is not a valid tender unless it was so agreed.

iii) **In case of tender of goods, it must give a reasonable opportunity to the promisee of ascertaining that the goods offered are the same as the promisor is bound to deliver**. Thus, a tender of goods at such time when the other party cannot inspect the goods, is not a valid tender.

iv) **It must be for the whole obligation**: A piecemeal tender of goods or to pay the amount in instalments is not a valid tender. For example, A promises to deliver 100 bags of rice on a certain day. If on the agreed day and place A offers to deliver 80 bags only. This is not a valid tender and A is not discharged from his obligation. However, a minor deviation from the terms of the contract may not render the tender invalid.

v) **It must be made to the promisee or his duly authorised agent**: Thus, a tender to a stranger is not valid. In case there are joint promisees, it is not necessary for the promisor to offer performance to each one of them. A tender may be made to any one of the joint promisees. Thus, a tender made to one of several joint promisees has the same legal effects as a tender to all of them.

vi) **In case of payment of money, tender must be of the exact amount due and it must be in the legal tender**. It should not be in any other form such as foreign currency or cheque. A payment by cheque is a valid tender provided the person to whom it is made is ready and willing to accept it.

7.2.4 Effect of Refusal to Perform Promise Wholly

When a party to a contract has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract. But, if the promisee has signified by words or conduct, his acquiescence in the continuation of the contract, he cannot terminate it. For example, A, a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights every week during the next two months, and B engages to pay her at the rate of Rs. 100 for each night. On the sixth night A wilfully absents herself from the theatre. In such a situation, B is at liberty to put an end to the contract. If however, with the consent of B, A sings on the seventh night, B has signified his acquiescence in the continuation of the contract and, therefore, he cannot now put an end to it. Of course, B is entitled to compensation for damage sustained by him through A's failure to sing on the sixth night.

7.3 WHO CAN DEMAND PERFORMANCE?

1. **Promisee**: Normally, the promisee is the only person who can demand performance of the promise under a contract. A third party cannot demand performance of the contract even if it was made for his benefit. For example, A promises B to pay Rs. 500 to C. The person who can demand performance is B and not C.

2. **Legal Representative**: In the case of death of the promisee, his legal representative can demand performance, unless a contrary intention appears from the contract or the contract is of a personal nature. For example, A agrees to marry B. However, before marriage takes place, H dies. Since it is a contract of personal nature the legal representative of B cannot demand performance of the promise from A.

3. **Third Party**: In some exceptional cases, the third party can also demand performance of the contract even though he is not a party to the contract. Such cases have been discussed in Unit 5 under the heading 'stranger to a contract'.

4. **Joint Promisees**: When a person has made a promise to two or more persons jointly, then, unless a contrary intention appears from the contract, the performance of the promise may be demanded either (i) by all the promises jointly; or (ii) in case of death of any of joint promisees, by the representatives of such deceased person jointly with the surviving promisees, or (iii) in case of death of all joint promisees, by representatives of all of them jointly. Thus, the right of joint promisees is only joint and any of them cannot demand performance unless it was so agreed. For example, A for a consideration of Rs. 5,000 lent to him by B and C, promises B and C jointly to repay them Rs. 5,000 plus interest on a specified day. B dies. The right to claim performance rests with B's representative jointly with C during his life time, and after C's death it would lie with the representatives of B and C jointly.

7.4 WHO MUST PERFORM?

You have learnt who can demand performance. Let us now understand who is to perform the contract. Normally, the contract should be performed by the promisor himself. However, in certain cases, it can also be performed by his agents or legal representatives. It all depends upon the intention of the parties. Normally a contract can be performed by the following persons.

1. **Promisor himself**: If from the nature of the contract it appears that it was the intention of the parties that the promise should be performed by the promisor himself, such promise must be performed by the promisor. This usually applies to contracts involving personal skill, taste or art work. For example, A promises to paint a picture for B. As this promise involves personal skill of A, it must be performed by A.

2. **Promisor or Agent**: Where the contract does not involve personal skill of the promisor, the contract could be performed by the promisor himself or by any competent person employed by him for the purpose, For example, A promises to pay to B a sum of money. A may perform this promise either by paying the money personally to B or by causing it to be paid to B by his authorised agent.

3. **Legal Representatives**: The contracts which do not involve any personal skill or taste may be performed by his legal representative after the death of the promisor. For example, A promises to deliver goods to B on a certain day on payment of Rs. 2,000. A dies before the said day. A's legal representatives are liable to deliver the goods to B and B is bound to pay Rs. 2,000 to A's representatives. If, however, the contract involves some personal skill or taste, it comes to an end with the death of the promisor.

4. **Third Person**: In some cases, a contract may be performed by a third person provided the promisee accepts the arrangement. According to Section 41, once the promisee accepts the performance from a third person, he cannot compel the promisor to perform the contract again.

5. **Performance of Joint Promises**: According to section 42, when two or more persons have made a joint promise, the joint promisors must fulfil the promise jointly during their life time. And if any one of them dies, then his legal representatives and survivors must jointly fulfil the promise. For example,

A, B and C jointly promise to pay Rs. 3,000 to D. A dies. B and C alongwith A's legal representative are jointly and severally liable to pay the amount to D. This rule is called 'devolution of joint liabilities'. It is however, subject to the condition that no other intention appears from the contract. In other words, if a contrary intention appears from the contract then the rule given above shall not apply.

In case the joint promisors do not perform their promise jointly, then Section 43 comes into operation. It provides *'When two or more persons make a joint promise, the promisee may, in the absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise.* Thus, the liability of joint promisors is joint and several and any of the joint promisors can be compelled to perform. For example, A, B and C jointly promised to pay Rs. 3,000 to D. In this case D may compel either A, or B or C to pay the entire amount of Rs. 3,000.

Section 43 further provides that unless a contrary intention appears from the contract, each joint promisor may compel every other joint promisor to contribute equally to the performance of the promise. If any joint promisor makes default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal shares. For example, A, B and C jointly promise to pay D Rs. 3,000. C is compelled to pay the whole amount, A is insolvent but his assets are sufficient to pay one half of his debts. C is entitled to receive Rs. 500 from A's estate and Rs. 1,250 from B.

In the above example if nothing could be recovered from A's estate, then C is entitled to recover Rs. 1,500 from B i.e., the loss of A shall be shared by B and C equally. It should be noted that when a promisee releases one of the joint promisors it does not discharge the other joint promisor or promisors. This means that the remaining joint promisors continue to be liable to pay the amount. The released joint promisor remains liable to contribute to the other joint promisors (section 44).

For example, A, B and C jointly promise to pay Rs. 3,000 to D. D releases A from liability, this release of A does not discharge B and C from their liability. If D recovers the entire amount from C, he can claim contribution from A and B.

7.5 TIME AND PLACE FOR PERFORMANCE

It is for the parties to a contract to decide the time and place for the performance of the contract. The rules regarding the time and place of performance are given in sections 46 to 50 of the Contract Act. These are as follows:

1. **Performance of a promise within a reasonable time**: According to section 46 where the time for performance is not specified in the contract, and the promisor himself has to perform the promise without being asked for by the promisee, the contract must be performed within a reasonable time. The question 'what is a reasonable time' is, in each particular case, a question of fact. Thus, it is clear from this provision that if time for performance is not stated, the contract is not bad for want of certainty.

2. **Performance of promise where time is specified**: Sometimes, the time for performance is specified in the contract and the promisor has undertaken to perform it without any application or request by the promisee. In such cases, the promisor must perform his promise on that particular day during the usual hours of business and at a place where the promise ought to be performed (section 47). For example, A promises to deliver goods at B's warehouse on January 1, 1990. On that day A brings the goods to B's warehouse, but after the usual hours of closing, and they are not received. A's performance is not valid.

3. **Performance of promise on an application by the Promisee**: It may also happen that the day for the performance of the promise is specified in the contract but the promisor has not undertaken to perform it without application or demand by the promisee. In such cases, the promisee must apply for performance at a proper place and within the usual hours of business, (Section 48)

4. **Performance of promise where no place is specified and also no application is to be made by promisee**: When a promise is to be performed without application or demand by the promisee, and no place is specified for performance, then it is the duty of the promisor to apply or ask the promisee to fix a reasonable place for the performance of the promise and to perform it at such place (Section 49). For example, A undertakes to deliver 1,000 kilos of jute to B on a fixed day. A must apply to B to fix a reasonable place for the purpose of receiving it, and must deliver it to him at such place.

5. **Performance of promise in the manner and time prescribed or sanctioned by promisee**: Sometimes the promisee himself prescribes the manner and the time of performance. In such cases, the promise must be performed in the manner and at the time prescribed by the promisee. The promisor shall be discharged from his liability if he performs the promise in the manner and time prescribed by the promisee (Section 50).

Examples:

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

ii) A desires B, who owes him Rs. 100, to send him a note for Rs.100 by post. The debt is discharged as soon as B puts into the post a letter containing note duly addressed to A.

7.6 TIME AS THE ESSENCE OF THE CONTRACT

The term 'time as the essence of the contract' means that the time is an essential factor and the concerned parties must perform their respective promises within the specified time. Now the question arises that if one of the parties fail to perform his promise in time then can the other party rescind the contract? This can be answered by finding out whether time was or was not the essence of the contract.

The mere fact that time is specified for the performance of a contract is not by itself sufficient to prove that time is the essence of the contract. For this we have

to ascertain the real intention of the parties. Time is generally considered to be the essence of the contract in the following cases.

a) Where the parties have expressly agreed to treat it as the essence of the contract;

b) Where the delay operates as an injury to the party; and

c) Where the nature and necessity of the contract requires it to be performed within the specified time.

In mercantile contracts, unless a different intention appears from the terms of the contract, time fixed for the delivery of the goods is considered to be the essence of the contract but not the time for the payment of the price. This is so because the prices of goods keep on fluctuating so rapidly that if punctuality is not observed it may result in heavy losses. But in case of the sale of an immovable property, the time is presumed to be not the essence of the contract.

According to Section 55 para 1 *where time is the essence of the contract and a party fails to perform his/her promise in time the contract becomes voidable at the option of the other party i.e.*, if the promisee wants he can rescind the contract. But in contracts where time is not the essence of the contract, if a party fails to perform the contract in time, then the other party cannot rescind the contract but it has the right

Check Your Progress A

1. What do you understand by performance of a contract?

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2. What is Tender?

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3. Who can demand performance of the contract?

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4. When is time the essence of the contract?

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5. State whether the following statements are True or False.

   i) A contract involving the exercise of personal skill can be performed by the agent or representative of the promisor.

   ii) In case of payment of a debt, refusal to accept the payment by the creditor does not discharge the debtor.

   iii) An offer to perform a promise is, in part, a valid tender.

   iv) If any one of the joint promisors makes default in making the payment, the other joint promisors must share the loss arising from such default equally.

   v) The promisee may compel any one of the joint promisors to perform the promise.

   vi) A release of one promisor does not discharge the other joint promisors.

   vii) In a contract where time is the essence of the contract, if the promisor fails to perform in time, the contract becomes void.

   viii) If the promisee accepts the performance from a third person, then he cannot compel the promisor to perform the promise again.

   ix) Where time for performance is specified, but is required to perform only on being asked by the promisee it is the duty of the promisee to apply for performance.

7.7 PERFORMANCE OF RECIPROCAL PROMISES

You have learnt that parties to an agreement make mutual promises to do or to abstain from doing something, they are known as 'reciprocal promises'. Section 2(f) of the Contract Act defines a reciprocal promise as *promises which form the consideration or part of the consideration for each other*. In such cases there is an obligation on each party to perform his own promise and to accept performance of the others' promises.

7.7.1 Types of Reciprocal Promises

Reciprocal promises have been classified by Lord Mansfield in **Jones v. Barkley** case in the following three categories:

a) **Mutual and independent**: When each party must perform his part of the promise independently without waiting for the performance or readiness to performance by the other party, the promises are called mutual and independent.

b) **Conditional and dependent**: When the performance of one party depends on the prior performance of the other party, the promises are called conditional and dependent.

c) **Mutual and concurrent**: When the parties have to perform their promises simultaneously, they are said to be mutual and concurrent.

7.7.2 Rules for the Performance of Reciprocal Promises

After having learnt the meaning and types of reciprocal promises, let us now discuss the rules regarding the performance of reciprocal promises.

1. **Mutual and Concurrent**: Section 51 lays down the rule by saying that when reciprocal promises are to be performed simultaneously, a promisor need not perform his part unless the promisee is ready and willing to perform his part. For example, A and B agree that A shall deliver goods to B to be paid for by B on delivery. In this case, A need not deliver the goods unless B is ready and willing to pay for the goods on delivery; and B need not pay for the goods unless A is ready and willing to deliver them on payment.

2. **Mutual and Dependent**: In such cases, the performance of promise by one party depends on the prior performance of the promise by the other party. If the party, who is liable to perform first, fails to perform it, then he cannot claim performance from the other party. Not only that, the party at fault becomes liable to pay compensation to the other party for any loss which the other party may sustain by the non-performance of the contract (section 54). For example, A contracts with B to execute certain building work for a fixed price. B is to supply the scaffolding and timber necessary for the work. B refuses to furnish any scaffolding or timber. So, the work cannot be executed. A need not execute the work and B will be bound to make compensation to A for any loss caused to him by the non-performance of the contract.

3. **Mutual and Independent**: You will notice that as it is clear from the name itself, such promises are to be performed by each party independently without waiting for the other party to perform his promise. If a party fails to keep his promise, the other party cannot excuse himself from performance on the ground of non performance by the defaulting party. In such a situation, the aggrieved party can claim damages from the defaulting party.

7.7.3 Order of Performance of Reciprocal Promises

Sometimes a problem arises, with regard to the order in which reciprocal promises are to be performed. In this connection section 52 of Contract Act provides that where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they must be performed in that order; and where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires. For example, A and B contract that A shall build a house for B at a fixed price. A's promise to build the house must be performed before B's promise to pay for it.

7.7.4 Effects of Preventing the Performance of Reciprocal Promises

Sometimes it may so happen that one party to a reciprocal promise prevents the other from performing his promise, In such a situation, the contract becomes voidable at the option of the party so prevented, and he is also entitled to claim compensation from the other party for any loss suffered due to non-performance

of the contract. For example, A and B contracted that B shall execute certain work for A for Rs. 1,000. B was ready and willing to execute the work accordingly. But, A prevents him from doing so. The contract is voidable at the option of B and if he decides to rescind it, he is entitled to recover from A compensation for any loss which he has incurred due to its non-performance.

7.8 ASSIGNMENT OF CONTRACTS

Assignment of contract means transfer of rights and liabilities arising out of a contract to a third party. An assignment to be complete and effective must be effected by an instrument in writing. Actually there are no specific provisions in the Contract Act dealing with assignment, it is a term used in the Transfer of Property Act.

You have already learnt that contracts involving personal skill or taste or ability must be performed by the promisor himself. In other words such contracts cannot be assigned. But where the contract is not of a personal nature, it can be assigned subject to certain conditions

Now let us see how the contract can be assigned? Contracts can be assigned in two ways: (a) By the act of parties and (b) by operation of law.

a) **Assignment by the act of parties**: This means that the parties themselves make the assignment. The rules in this regard are as under:

   i) The liabilities or obligations under a contract cannot be assigned. It means that the promisor cannot compel the promisee to accept some other person as the promisor in his place. For example, A owes B Rs. 500 and A is also to recover Rs. 500 from P. A cannot compel B to recover the money from P. But, the promisor may transfer his liability to a third person with the consent of the promisee and the transferee. In the example given above, A can transfer his liability to P with the consent of B and P. This is technically known as 'novation'.

   ii) If the contract does not expressly or impliedly provides that the contract shall be performed by the promisor only, the parties can decide that the performance be done by another competent person. But, even then the promisor remains liable to the promisee for proper performance.

   iii) The rights and benefits under a contract, which is not of a personal nature, can be assigned. For example, A owes B Rs. 1,000. B may assign his right to C. But in such a situation the assignee takes assignment subject to all equities between the original parties. In the above example if A has already paid a portion of the debt to B, he will be liable to pay to C a correspondingly less amount.

   iv) An actionable claim can always be assigned. But this must be done by an instrument in writing. It is also necessary that a notice of assignment has been given to the debtor. An actionable claim is a claim to any debt (except a secured debt) or to any beneficial interest in movable property. Examples of actionable claims are book debts, money debts, right of action arising out of a contract etc.

b) **Assignment by operation of Law**: Contracts which are not of a personal nature get assigned due to operation of law. Assignment by operation of law takes place in cases of death or insolvency of any party to the contract. Upon the death of a party to the contract his rights and obligations automatically pass on to his heirs or legal representatives. In case of insolvency, all the rights and obligations pass on to the official Receiver or Assignee.

7.9 APPROPRIATION OF PAYMENT

The term 'appropriation of payment' means the application of payment. When a debtor owes several distinct debts to one creditor and makes a payment to the creditor which is insufficient to discharge all the debts, a problem may arise as to which particular debt, should the payment be applied. In some cases the debtor may himself expressly point out to which particular debt the payment be applied, while in others the circumstances may indicate the debt to the payment is to be applied. But the difficulty arises when neither there is an express indicating nor can it be implied from circumstances. In India, the rules regarding appropriation of payments are given in sections 59 to 61. These rules are as following.

1. **Where there is an express or implied intimation by the debtor** (Section 59): A debtor has the right to instruct his creditor to which particular debt the payment is to be applied. If the creditor accepts the payment, he is duty bound to follow the instructions. If the debtor expressly informs the creditor while making payment that the payment be applied to a particular debt, the creditor must do so. But if there is no express intimation by the debtor then the intention should be seen from the circumstances of the case. Let us now explain this rule by the following two examples:

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

   A owes B, among other debts, the sum of Rs. 567. B writes to A and demands payment of the sum. A sends Rs. 567. This payment is to be applied to the discharge of the debt of which B had demanded payment.

   You should note that if the creditor does not want to apply the payment as per the express or implied instructions of the debtor, he must refuse to accept the payment. In no case the creditor can alter the appropriation after accepting the payment.

2. **Where there is no express or implied intimation**: If, while making the payment, the debtor does not intimate and there are no circumstances indicating to which debt the payment is to be applied, then the creditor has the option to apply the payment to any lawful debt due from the debtor. The amount, in such a case, can be applied even to a debt which has become time-barred. However, it cannot be applied to a disputed debt. But, once an appropriation has been made by the creditor and the debtor is informed, the creditor cannot change his option later on.

3. **Where neither party appropriates**: Where neither the debtor nor the creditor makes any appropriation, the payment shall be applied in discharge of the debts in order of time, whether or not they are time-barred. If the debts are of equal standing, the payment shall be applied in discharge of each proportionately. It should be noted that where moneys are received by the creditor without any definite appropriation on either side, the money so received must first be applied in payment of interest and then in payment of principal.

Check Your Progress B

1. What are reciprocal promises?

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2. Classify reciprocal promises.

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3. What do you mean by assignment of contracts?

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4. State whether the following statements are True or False?

 i) Promises forming consideration for each other are known as reciprocal promises.

 ii) Promises which are to be performed simultaneously are termed as mutual and independent.

 iii) Where the performance by one party depends on the prior performance of the other party, they are mutual and dependent promises.

 iv) Contractual obligations involving personal skill or ability cannot be assigned.

 v) Assignment by operation of law takes place in cases of death or insolvency.

 vi) A debtor while making the payment expressly informs the creditor that the payment should be applied to a particular debt, the creditor is not bound to do so.

 vii) Where the debtor does not intimate and there are no circumstances indicating debt to which the payment is to be applied, the creditor may apply it at his discretion to any lawful debt due.

 viii) While making payment if the debtor does not specify the debt to which the payment is to be applied. Creditor can apply the payment even to a time-barred debt.

7.10 MODES OF DISCHARGE OF A CONTRACT

You have learnt that a valid contract creates certain obligations for the contracting parties and the parties become liable to fulfil their irrespective promises.

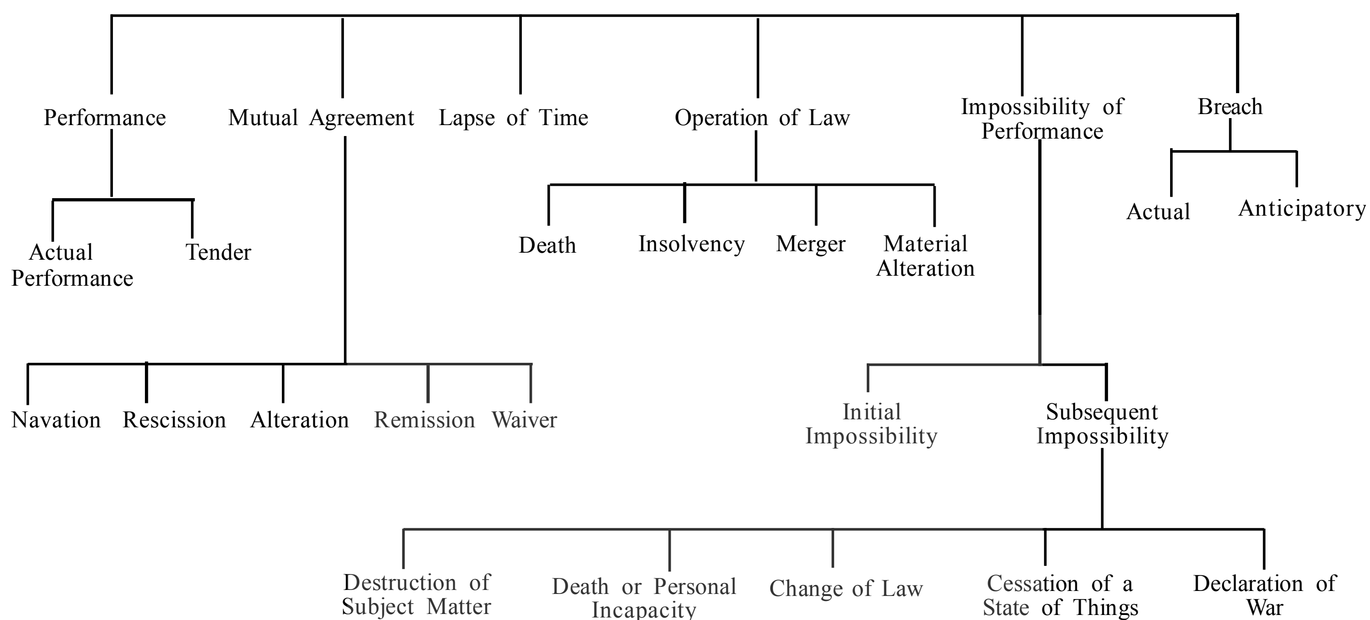

Fig. 7.1: Modes of discharge of a contract

When such promises are performed, the contract is said to be discharged. The term 'discharge of a contract' means that the parties to it are no more liable under the contract. The most obvious or desirable method of discharge of a contract is to perform it. We have discussed the various rules regarding the performance in the foregoing pages. Let us now have some idea about the other modes of discharge of a contract.

A contract may be discharged in any one of the following ways:

1. By performance
2. By mutual agreement
3. By lapse of time
4. By operation of law
5. By impossibility of performance
6. By breach.

Look at Figure 7.1 for various modes of discharge of a contract. Now we shall study these modes one by one.

7.10.1 Discharge by Performance

The most obvious or natural mode of discharge of a contract is by performance. The performance may be either actual or an attempted one. You have learnt about the performance in section 7.2 of this unit.

7.10.2 Discharge by Mutual Agreement

Just as a contract is created by means of an agreement, it can be terminated or discharged by mutual agreement. If the parties to a contract agree to make a fresh contract in place of the original contract, the original contract is discharged. A contract can be discharged by mutual agreement in any of the following ways.

a) **Novation**: The term 'novation' means the substitution of a new contract for the existing one. This arrangement may be either between the same parties or between different parties. The consideration for the new contract is the discharge of the original contract. Since novation implies a new contract, all the parties to the existing contract must agree to it.

Examples

i) A owes money to B under a contract. It is agreed between A, B and C that B shall thenceforth accept C as his debtor instead of A. The old debt of A to B is discharged, and a new debt from C to B has been contracted. This is novation involving change of parties.

ii) A owes B Rs. 10,000. A enters into an agreement with B and gives B a mortgage of his estate for Rs. 5,000 in place of the debt of Rs. 10,000. This arrangement constitutes a new contract and terminates the old.

b) **Rescission**: Rescission means cancellation of the contract. If by mutual agreement the contracting parties agree to rescind the contract, the contract is discharged. A contract can be rescinded before the performance becomes due. Non-performance of a contract by both the parties for a long period, without complaint, amounts to implied rescission. Rescission is different from novation in the sense that in case of novation a new contract is substituted for the original contract whereas in rescission the original contract is cancelled and no new contract is made.

c) **Alteration**: It means a change in one or more of the terms of a contract with consent of all the parties. Alteration has the effect of terminating the original contract. In an alteration there is a change in the terms of a contract but no change of parties to it. In novation there may be change of parties.

d) **Remission**: It means the acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made. According to section 63, every promisee may (a) remit or dispense with it, wholly or in part, or (b) extend the time of performance, or (c) accept any other satisfaction instead of performance. A owes B Rs. 5,000. A pays to B Rs. 3,000 who accepts it in full satisfaction of the debt. The whole debt is discharged.

e) **Waiver**: Waiver means abandonment or intentional relinquishment of a right under the contract. When a party waives his rights under it, the other party is released from his obligation. For example, A promises to paint a picture for B. B afterwards forbids him to do so. A is no longer bound to perform the promise.

7.10.3 Discharge by Lapse of Time

The rights and obligations under a contract can be enforced only within a specified period called the 'period of limitation'. The Limitation Act has prescribed the period of limitation for various contracts. For example, period of limitation for exercising right to recover an immovable property is twelve years and right to recover a debt is three years. After the expiry of this limitation period, the contractual rights cannot be enforced. In other words, if a debt is not recovered within three years of its payment becoming due, the debt becomes time barred and is discharged by lapse of time.

7.10.4 Discharge by Operation of Law

A contract may be discharged by operation of law in the following cases.

i) **Death of the Promisor**: Contracts involving the personal skill or ability of the promisor come to an end with the death of the promisor.

ii) **Insolvency**: When a person is declared insolvent by an Insolvency Court, he is discharged from his obligation existing at that time. So, if a promisor is declared insolvent, he is discharged from his liability.

iii) **Merger**: When an inferior right accounting to a party in a contract merges into the superior rights accruing to the same party, the earlier contract is discharged. For example, A took a land on lease from B. Subsequently, A purchases that very land. Now A becomes the owner of the land and the earlier contract of lease stands terminated.

iv) **Material alteration**: In a written contract if any party makes some material alteration in the terms of the contract without the approval of the other party, the contract stands terminated. A material alteration is one which varies the rights, liabilities or the position of the parties as such, you should note that immaterial alterations, such as correcting the clerical errors or the spelling of a name has no effect on the validity of the contract.

7.10.5 Discharge by Impossibility of Performance

You learnt in Unit 1 that for a contract to be valid it must be capable of being performed. But sometimes, due to some reasons which are beyond the control of the parties, the performance of a contract becomes impossible. In such cases, the contract is discharged on the ground of impossibility of performance. Section 56 of Contract Act provides that an agreement to do an act impossible in itself is void. This rule is based on the principle that law does not recognise the impossible and what is impossible does not create any obligations.

Impossibility may be of two types: (i) initial and (ii) subsequent.

Initial impossibility: It means impossibility at the time of making the contract. Whether the fact of impossibility is known or unknown to the parties, the agreement is void ab-initio. For example A agrees with B to discover a treasure by magic. The agreement is void due to initial impossibility.

If, however, the promisor alone knows about the initial impossibility while making the contract, he shall have to compensate the promisee for any loss which the promisee may suffer on account of non-performance. This rule is given in Para 3

of section 56. For example, A contracts to marry B, being already married to C. Being forbidden by the law of which he is subject to practise polygamy, A must compensate B for the loss caused to her by the non-performance of the contract on account of impossibility.

You should note that where initial impossibility is unknown to both the parties, the contract will become void because of mutual mistake of fact. For example, A agrees to sell his horse to B for Rs. 1000. Unknown to both the parties, the horse was dead at the time of making the agreement. This agreement is void.

Subsequent or Supervening Impossibility: Impossibility which arises subsequent to the making of the contract is called supervening impossibility. If the contract was capable of performance at the time of making it, but subsequently because of some event (over which neither party has any control) the performance becomes impossible or unlawful, the contract becomes void and the parties are discharged from their obligations.

You will notice that supervening impossibility is different from initial impossibility. In case of initial impossibility the agreement is void ab-initio while in case of supervening impossibility the contract becomes void.

The doctrine of supervening impossibility is contained in Para 2 of Sec. 56 which provides: *A contract to do an act which after the contract is made becomes impossible, or by reasons of some event which the promisor could not prevent, becomes void when the act becomes impossible or unlawful.*

The contract will become void on the ground of supervening impossibility only if the following conditions are satisfied.

a) The act should have become impossible.

b) The impossibility should be by reason of some event which the promisor could not prevent.

c) The impossibility should not be self-induced by the promisor.

The performance of a contract may become subsequently impossible due to any of the following reasons.

1. **Destruction of Subject-Matter**: If the subject-matter of a contract is destroyed after the formation of the contract, without the fault of either party, the contract becomes void.

   Examples

   i) A musical hall was agreed to be let out on certain dates, but before those dates the hall was destroyed by fire. The contract was held to have become void on the ground of impossibility of performance (**Taylor v. Caldwell**).

   ii) A person agreed to deliver a part of a specific crop of potatoes. The potatoes were destroyed by a pest through no fault of the party. The contract was held to be discharged (**Howell v. Coupland**).

2. **Death or personal incapacity**: When the performance of a contract depends upon the personal skill or ability of a party, the contract stands discharged on the death or incapability of that person. For example, A agreed to perform at a concert on a specified day. A fell seriously ill and so could not perform on the said day. It was held that the contract is discharged on the ground of impossibility (**Robinson v. Davison**).

3. **Change of Law**: A contract which was lawful at the time of making it but becomes unlawful by reasons of subsequent change in law, the performance becomes impossible and the contract is discharged.

   Examples

   i) A agreed to transport certain goods belonging to B from one place to another. Subsequently, A's trucks were requisitioned by the Government under a statutory power. It was held that A was discharged from his obligation (**Noor Bux v. Kalyan**).

   ii) A agreed to sell his land to B. Subsequently, the land was acquired by the Government. Now A cannot perform his promise, the contract was held to become void on the ground of impossibility (**Shyam Sunder v. Durga**).

4. **Cessation of a state of things**: If a contract is entered into on the basis of the continued existence or occurrence of a particular state of things, the contract is discharged if the state of things ceases to exist or changes. It should be noted carefully that the contract is discharged only when the happening of the event was the basis of the contract.

   Examples

   i) A and B contract to marry each other. Before the time fixed for the marriage, A goes mad. The contract becomes void.

   ii) A took a room on hire in a hotel for viewing the coronation procession of King Edward VII. Because of King's illness the procession was cancelled. It was held that A was not liable to pay the room rent because the very purpose of hiring the room was defeated (**Knell v. Henry**). This type of supervening impossibility is also called 'frustration of contract'.

5. **Declaration of War**: If a war is declared subsequent to the formation of the contract, all pending contracts are either suspended or declared as void. If the war is of a short duration, such contracts may be revived after the end of the war. For example, A contracts to take in cargo for B at a foreign port. A's Government afterwards declares war against the country in which the port is situated. The contract becomes void when the war is declared.

Exceptions i.e., cases not covered by supervening impossibility: The above rule is not applicable in some cases. When a person has promised do something, he must fulfil his promise unless the performance becomes absolutely impossible. Impossibility of performance is, as a rule, not an excuse from performance. Some of the cases which do not come within the principle of supervening impossibility are as follows:

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a) **Difficulty of Performance**: The contract is not discharged simply because the performance has become more difficult, more expensive or less profitable than stipulated at the time of its formation.

Examples

i) A agreed to supply coal within certain period. Due to government's restrictions on the transport of coal from collieries, he failed to supply in time. But since coal was available in the open market from where A could have obtained it, A will not be discharged on the ground of impossibility.

ii) A promised to send certain goods from Bombay to Antwerp in September. In August, war broke out and shipping space was not available except at very high rates. It was held that the increase of freight rates did not excuse performance.

b) **Commercial Impossibility**: Performance cannot be excused on the ground of commercial impossibility. If the raw material is available at a very high rate or wages have gone up and the performance becomes less profitable than anticipated, the contract does not become void. Commercial impossibility does not discharge the parties. For example, A agreed to supply certain goods to B. As a result of an increase in the cost of raw material and wage bill, it is now no longer profitable for A to supply the goods at the agreed rate, A cannot be excused for non-performance.

c) **Default of a Third Party**: If the contract cannot be performed because of the default of a third person on whose work the promisor relied, the promisor is not discharged. For example, A entered into a contract with B for the supply of certain cotton goods to be manufactured by C, a manufacturer of these goods. C did not manufacture those goods. A is not discharged from his obligation and is liable to B for damages.

d) **Strikes, Lockouts and Civil Disturbances**: A strike by the workers or a lockout by the employer or riots etc. will not excuse the parties from performing the contract unless there is a clause in the contract to that effect. For example, a contract was entered into between two merchants for the sale of certain goods which were to be imported from Algeria. The goods could not be imported because of riots and civil disturbances in that country. It was held that this was no excuse for non-performance of the contract.

e) **Partial Impossibility**: If the contract is made for several purposes, the failure of one or more of them does not discharge the contract. For example, A agreed to let a boat to H to (i) view the naval review at the coronation of King, and (ii) to cruise round the fleet. Due to the illness of the King, the naval review was cancelled, but the fleet was assembled and the boat could have been used to cruise round the fleet. It was held that the contract was not discharged.

Effects of Supervening Impossibility

a) **Contract becomes void**: When the performance of a contract becomes subsequently impossible or unlawful; the contract becomes void (section 56 para 2).

b) **Compensation for Non-performance**: When the promisor alone knows that the performance is impossible or unlawful, he must compensate the promisee for any loss which he might have suffered on account of non-performance (section 56 para 3).

c) **Benefit to be Restored**: When a contract becomes void, any person who has 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 (section 65). For example, A contracts to sing for B at a concert for Rs. 1,000, which is paid in advance, A is too ill to sing. A must refund the advance of Rs. 1,000 to B.

7.10.6 Discharge by Breach

You have learnt that when a contract is made, the parties to it are expected to perform it, unless they are excused. *If any party refuses or fails to perform his part of the contract, a breach of contract occurs and* the contract is discharged. In case of breach the aggrieved party is relieved from performing his obligation and gets a right to proceed against the party at fault. A breach of contract may arise in two ways: (i) actual breach and (ii) anticipatory breach.

Actual Breach: Actual breach of contract may take place either on the due date of performance or during the course of performance. For example, A agreed to deliver 100 bags of rice to B at a certain price on 10th July. If A refuses or fails to deliver the goods on time, there occurs an actual breach. If the promisor has performed part of the contract and then refuses or fails to deliver the remaining goods, it is also actual breach of contract.

Anticipatory Breach: Anticipatory breach occurs when the party declares his intention of not performing the contract before the performance is due. This intention may be declared expressly by words written or spoken or impliedly. For example, A agrees to supply certain goods to B on 10th July. Before this date A informs B that he shall not supply the goods or instead expressly informing B about his intention of not performing the contract, A does something which makes it impossible for him to perform, this will also amount to anticipatory breach. If in the example given above, A sells all the goods before the said date to P at a higher price, this action of A clearly indicates his intention.

Thus a breach of contract operates a discharge of contract. In case of breach, the aggrieved party gets the right to claim compensation or damages from the defaulter. The various remedies available to the aggrieved party shall be discussed in unit 8.

Check Your Progress C

1. What is 'Novation'?

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2. Does death of the promisor discharge the contract in all cases?

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3. State the doctrine of supervening impossibility?

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4. When is the contract discharged by operation of law?

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5. State whether the following statements are True or False:

   i) If a new contract is substituted in place of an existing contract, it is called alteration.

   ii) Insolvency of the promisor discharges the contract.

   iii) Impossibility of performance is not an excuse for non-performance of a contract.

   iv) Difficulty in performing the contract makes it void.

   v) If a contract could not be performed because of a default by a third person on whose work the promisor relied, the contract becomes void.

   vi) An agreement to do an act impossible in itself is void.

   vii) Anticipatory breach of contract takes place before the performance is due.

7.11 LET US SUM UP

The most natural way of terminating the contract is to perform it. The performance may be either actual or attempted (also known as Tender). When a party offers to perform his promise in accordance with the contract, and the other party

refuses to accept it, the contract is discharged. Attempted performance or tender is equivalent to actual performance. The party who offered to perform is discharged from his obligation. The tender to be valid must be unconditional, made at the proper time, place and manner, made to the promisee or his authorised agent, and must be for the whole obligation.

Performance can be demanded by the promisee only. In case of his death his representatives can demand performance. In case of contracts of a personal nature, they should be performed by the promisor. In other cases, it may be performed by his agent, and in case of his death by his legal representatives.

When two or more persons make a joint promise, then unless a contrary intention appears from the contract, all of them must perform jointly. If any one of the joint promisors dies, his legal representative shall be liable to perform along with other joint promisors.

The contract should be performed at the time specified and at the place agreed upon. If no time is specified the promisor must perform the promise within a reasonable time. In case no time and place is fixed for the performance, the promisee must ask the promisor to fix the day and time for performance. In commercial agreements, time is the essence of the contract.

Promises which form the consideration or part of the consideration for each other are termed as reciprocal promises. Reciprocal promises may be (a) mutual and independent, (b) conditional and dependent, and (c) mutual and concurrent. Reciprocal promises must be performed in the order specified in the contract.

Assignment of a contract means transfer of rights and obligations under a contract to third party. It may be done by the act of the party or by operation of law. Rights and benefits under a contract can be duly assigned. But, a promisor cannot assign his liabilities. Contracts of a personal nature cannot be assigned.

Appropriation means applying the payment to a particular debt. If, while making the payment, the debtor specifies the debt to which it should be applied, then the creditor must appropriate the payment to that debt only. In case the debtor does not specify the debt to which it should be applied, the amount can be appropriated by the creditor in the manner he deems it fit.

A contract may be discharged by mutual agreement which may take the form of Novation, Alteration, Rescission, Waiver or Merger. A contract stands discharged if it is not performed within the period of limitation and no action is taken by the promisee. It can be discharged by operation of law also, This includes discharge by death, insolvency, merger, material alteration.

When the performance of a contract becomes impossible or unlawful after the formation of the contract, the contract becomes void on the ground of supervening impossibility. Supervening impossibility may arise due to the destruction of the subject matter, death or personal incapacity of the promisor, change of law, outbreak of war, non-existence of a state of things. The contract is discharged in these cases. However, the contract will not be discharged in case of a) difficulty of performance, b) commercial impossibility, c) default by a third party, d) strikes, lockouts and civil disturbances.

A contract is also discharged by breach of contract. When either party fails or refuses to perform his promise, a breach of contract takes place. Breach may be either actual or anticipatory. Actual breach takes place at the time when performance is due or during the course of performance. Anticipatory breach means when a party declares his intention of not performing his promise before the due date of performance.

7.12 KEY WORDS

Appropriation: Applying the payment to a particular debt is called appropriation.

Assignment: When a party transfers his rights and interest in the contract to another person, he is said to assign the contract.

Breach: When a contracting party refuses to perform his obligation, there is a breach of contract.

Contribution: When a joint promisor has performed the whole of the promise, he may claim the share from other joint promisors. This is known as contribution.

Joint promisors: When a promise is made by two or more persons, they are known as joint promisors.

Novation: When a new contract is substituted for an existing one either between the same parties or new parties, it is termed novation.

Period of Limitation: A time laid down in the Law of Limitation for performing various contract. If it is not performed during this period, the performance becomes time barred.

Reciprocal promise: A promise made in consideration of other party's promise is reciprocal promise.

Remission: Acceptance of lesser performance than what was contracted for is known as remission.

Rescission: When one or all the terms of a contract are cancelled, it is termed as rescission.

Tender: An offer to perform a promise.

7.13 ANSWERS TO CHECK YOUR PROGRESS

A) 5. i) False, ii) True, iii) False, iv) True, v) True, vi) True, vii) False, viii) True, ix) True.

B) 4. i) True, ii) False, iii) True, iv)True, v)True, vi) False, vii) True, viii) True.

C) 5. i) False, ii) True, iii) True, iv) False, v) False, vi) True, vii) True.

7.14 TERMINAL QUESTIONS

1. What do you mean by performance of a contract?
2. What is meant by tender? What are the essentials of a valid tender?

3. Who should perform the contract? Is performance of a contract by a third party valid?

4. Explain the legal rules relating to time and place of performance of a contract.

5. "Time is the essence of the contract". Comment.

6. Discuss the law relating to assignment of contracts.

7. Define the term 'Reciprocal Promise'. State the rules for the performance of reciprocal promises.

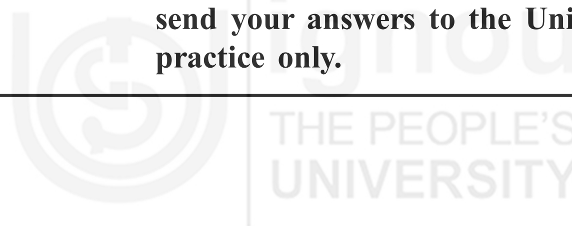
8. State the various modes of discharge of a contract.

9. Explain with examples the doctrine of supervening impossibility.

10. Explain the meaning of 'Novation'. How novation is different from rescission?

11. State the rules regarding appropriation of payment.

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.



UNIT 8 REMEDIES FOR BREACH AND QUASI CONTRACTS

Structure

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- 8.2.2 Actual Breach of Contract

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8.8 Answers to Check Your Progress

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8.0 OBJECTIVES

After studying this unit, you should be able to:

- explain as to what amounts to a breach of contract;
- list the remedies in case of breach of contract;
- describe the circumstances under which the various remedies shall be available; and
- define quasi contracts and describe various types of quasi contracts.

8.1 INTRODUCTION

In unit 7 you learnt about the performance of a contract by the parties and consequent termination of the contract. What happens, if the parties refuse or fail to perform the agreed obligation? Such a failure or refusal results in what is called as breach of contract. In this unit you will learn about the meaning of breach of contract, kinds of breach of contracts and the remedies available to the other party in case of a breach of contract. You will also learn about

the nature and effects of certain transactions called quasi contracts which are not contracts in the strict sense of the term, but generate obligations similar to those created by contracts.

8.2 MEANING OF BREACH OF CONTRACT

As you know, the term 'agreement' is defined under section 2(e) as 'reciprocal promises'. Thus, both the parties are subjected to an obligation to do or not to do something. In case any of the parties fails to carry out his agreed obligation or by his act makes it impossible to perform his obligations under the contract, he is said to have committed the breach of that contract. Breach of contract may arise in two ways: (i) anticipatory breach, and (ii) actual breach. Let us now study these two in detail,

8.2.1 Anticipatory Breach of Contract

Anticipatory breach of contract occurs when a party repudiates the contract before the time fixed for its performance or when a party by his own act disables himself absolutely from performing the contract.

Examples

1. A contracts to marry B. Before the agreed date of marriage, he marries C. In this case, A has committed anticipatory breach of contract.

2. A contracts to supply B with certain articles on 1st of August. On July 20, he informs B that he will not be able to supply the goods. A has committed anticipatory breach of contract.

Section 39 deals with anticipatory breach of contract. It provides *when a party to a contract has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or by conduct, his acquiescence (willingness) in its continuance*. For example, A who is a singer, enters into a contract with B, the manager of a theatre, to sing at his theatre two nights in every week during the next two months. B agrees to pay her 100 rupees for each performance. On the sixth night A wilfully absents herself from the theatre. B is at liberty to put an end to the contract. In this example, if B permits A to sing on the seventh night, B has signified his willingness in the continuance of the contract. He cannot now put an end to it but is entitled to compensation for the damage sustained by him through A's failure to sing on the sixth night.

Reading through the provisions of Section 39 and the aforesaid example, you would have noted that in the event of an anticipatory breach i.e., where a party to a contract refuses to perform his part of the contract before the actual date of performance, the promisee shall have two options: (i) rescind the contract and sue for damages for breach of contract without waiting until the due date for performance, or (ii) may not rescind the contract but treat the contract as operative and wait for the time of performance and then hold the other party liable for the consequences of non-performance. You should note that in case the promisee decides not to rescind the contract, the contract shall remain alive for the benefit of both the parties. But if during the intervening period i.e., the date of breach and the due date of the performance, any event happens that

intervene (e.g., supervening impossibility) for the benefit of the promisor, the promisee shall lose his right to sue for damages. For example, A agreed to load a cargo of wheat on B's ship by a particular date, When the ship arrived, A refused to load the cargo, but B did not accept the refusal and continued to demand the cargo. Before the last date of loading had expired the war broke out, rendering the performance of the contract illegal. The contract has come to an end by frustration and B cannot sue A for damages (**Avery v. Bowden**).

In case of anticipatory breach of contract, the aggrieved party may claim damages either at the time when such a breach is committed or wait till the time when the performance becomes due and claim damages if promise still remains unperformed. **However, the amount of damages claimable shall vary in the two cases**. This difference can be clarified with the help of an example, X agrees to sell to Y a certain quantity of wheat at Rs. 300 per quintal to be delivered on August 3. On July 2, X gives notice expressing his unwillingness to sell wheat, and the price of wheat on the date is Rs. 400 per quintal. If Mr. Y repudiates the contract forthwith (which he is entitled to do at his option), he would be able to recover damages @ Rs. 100 per quintal which is the difference between market price and the contract price on July 2. If, instead of taking the action forthwith, he keeps the contract alive till August 3, and in the mean time, the price increases to Rs. 500 per quintal. Y would be able to recover damages @ Rs. 200 per quintal.

8.2.2 Actual Breach of Contract

Actual breach of contract may take place in any of the two ways: (i) breach at the time when the performance of contract is due, or (ii) breach of contract during the performance of the contract. Now let us study about these two separately in detail.

Actual breach of Contract at the time when performance is due. If a party to contract refuses or fails to perform his part of the contract at the time fixed for performance of that contract, he will be liable for its breach. For example, A agreed to sell his car to B on July 2. On July 2 A refused to sell his car to B. On A's refusal to sell the car, there is an actual breach of contract. Now the question is whether it should be accepted or whether the promisee can refuse such performance and hold the promisor liable for the breach. The answer depends upon whether time was considered by the parties to be the essence of the contract or not.

In this respect, Section 55, lays down, *when a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified timed, the contract, or so much of it as has not been performed, becomes voidable at the option of the promisee, if the intention of the parties was that time should be the essence of the contract.*

If it was not the intention of the parties that time should be the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time. But the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure. If, in case of a contract voidable on account of the promisor's failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any

loss the occasioned by non-performance of the promise at the time agreed unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so. For example, A, a singer, contracts with B, the manager of a theatre to sing at his theatre two nights in every week during the next two months, and B agrees to pay her 100 rupees for each night's performance. On the sixth night A wilfully absents herself from the theatre and B, in consequence, rescinds the contracts. B is entitled to claim compensation for the damage which he has sustained through the non- fulfilment of the contract by A.

According to the aforesaid provisions, if performance beyond the stipulated time is accepted, the promisee must give notice of his intention to claim compensation. If he fails to give such notice, he will be deemed to have waived that right.

Actual breach of contract during the performance of the contract

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. For 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 instalments. After a few instalments has been supplied, the Railway Company asked A to deliver no more. Held, A could sue for breach of contract (**Cort v. Ambergate etc. Rly Co.**).

8.3 REMEDIES FOR BREACH OF CONTRACT

When a contract is broken by a party, there are several courses of action (remedies) which the other party may pursue. These remedies include:

- Rescission of the contract
- Suit for damage
- Suit for specific performance
- Suit for injunction
- Suit upon quantum meruit

8.3.1 Rescission of the Contract

As you have read section 39 of the Act provides that when a party to a contract has refused to perform, or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract. This is called right of rescission. It means setting aside of the contract. In such a case aggrieved party is discharged from all obligations under the contract. For example, A promises to supply the furniture B's new office on a certain day. B promises to pay for the furniture on its receipt. A does not supply the furniture on the agreed date. B is discharged from the liability of paying the price and can rescind the contract.

It should be noted that section 75 of the Indian Contract Act also confers upon a person rightfully rescinding the contract to make a claim for compensation of any loss or damage sustained through the non-fulfilment of the contract. Thus, in the above example B shall not only be entitled to rescind the contract but also to claim compensation for the damage which he has sustained because of the non-supply of furniture by A on the specified date.

8.3.2 Suit for Damages

In the event of breach of contract the aggrieved party besides rescinding the contract can claim for damages. Damages are monetary compensation allowed

for loss suffered by the aggrieved party due to the breach of contract. The object of the court in awarding damages for breach is that the aggrieved party may be put in the financial position which would have existed had there been no breach of contract. The law does not punish a party because he has broken a contract but if, by reason of his wrongful act, the other party has suffered any pecuniary (monetary) loss, the court will compel the party in breach to compensate the loss by paying damages to the other party.

In India, the rules relating to damages are based on the judgement in English case of **Hadley v. Baxendale**. The facts of this case were: H's mill was stopped due to the breakdown of a shaft. He delivered the shaft to B, a common carrier, to be taken to the manufacturer to copy it and make a new one. H had not made it known to B that delay would result in a loss of profits. By some neglect on the part of B, the delivery of the shaft was delayed in transit beyond a reasonable time. Held, B was not liable for loss of profits during the period of delay as the circumstances communicated to B did not show that a delay in the delivery of shaft would entail loss of profits to the mill. The following rule of law was laid down in this case: '*Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally i.e., according to the usual course of things, from such breach of contract itself or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it*'.

Section 73, of the Indian Contract Act which deals with compensation for loss or damage caused by breach of contract is based on the judgement in the above case. It states that the aggrieved party may claim the damages as follows:

a) Such damages which naturally arose in the usual course of things from such breach. This relates to ordinary damages arising in the usual course of things.

b) Such damages which the parties knew when they made the contract, to be likely to result from the breach. This relates to special damages.

c) The aforesaid compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach, and

d) Such compensation for damages arising from breach of quasi contract shall be same as in any other contract,

Rules Relating to Different Types of Damages: We may now consider in detail the types of damages and rules relating to them.

1. **Ordinary Damages**: Ordinary 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 on the date of the breach. If the seller retains the goods after the breach, he cannot recover from the buyer and further loss if the market falls, nor is he liable to have the damages reduced if the market rises. For example A contracts to deliver 100 bags of rice at Rs. 100 per bag on a future date. On the due dates he refuses to deliver. The market price on that day is Rs. 110 per bag. The measure of damages is the difference between the market price on the date of the breach and the contracted price i.e., Rs. 110 − 100 = Rs. 10.

You should note that section 73 specifically provides for compensation for any loss or damage which arise naturally in the usual course of things from the breach and as such compensation cannot be claimed for any remote indirect loss or damage by reason of the breach. For example, 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 and she had to walk a long distance in drizzling night to reach home. In a suit by the plaintiff against the railway company, it was held that damages for the personal inconvenience of the plaintiff alone would be granted, but not for sickness of the plaintiff's wife because it was very remote consequence (**Hobbs v. London and S**).

2. **Special Damages**: Damages other than those arising directly from the breach may be recovered if such damages may reasonably be supposed to have been in contemplation of both the parties as the probable result of the breach of a contract. Such damages are known as 'special damages'. Thus, 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 promisee to not only the ordinary damages but also special damages that may result therefrom. For example, A, who is a builder, agrees to erect and finish a house by 1 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 it falls down before 1 January and has to be rebuilt by B. As a consequence, B 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. Here, you should note that the communication of the special circumstances is a pre-requisite to the claim for special damages. The case of **Hadley v. Baxendale** which laid down the rules regarding 'special damages' in England is the most celebrated illustration on the point. The facts of this case have already been discussed.

3. **Exemplary/ Punitive/ Vindictive Damages**: Exemplary (also called punitive or vindictive damages), are intended to show the court's strong disapproval of the conduct or the defendant in committing the wrong. They are not proportionate to the actual pecuniary loss sustained by the aggrieved party but are inflicted by way of punishment. These are normally awarded in case of (i) a breach of promise to marry, or (ii) wrongful dishonour of a cheque by a banker. The measure of damages in case of breach of promise to marry is dependent upon the severity of the shock to the sentiments and goodwill of the promisee. In case of wrongful dishonour of a cheque, the rule is smaller the amount of the cheque, larger will be the amount of damages awarded and vice versa.

4. **Nominal Damages**: Nominal damages are awarded in case of breach of contract where there is only a 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, say, a rupee. It may be noted that the aggrieved party cannot claim these damages as a matter of right. It is always at the discretion of the court whether or not to award nominal damages.

5. **Damages for Deterioration Caused by Delay**: In the case of deterioration caused to goods by delay, damages can be recovered from carrier even without notice. The word 'deterioration' implies not only physical damages to the goods but also loss of special opportunity for sale. In the case of **Wilson v. Lancashire and Yorkshire Railway Co.** the plaintiff had bought velvet for making caps for sale during the spring. But, due to delay in transit, he was unable to utilise it for making caps for sale during the season. It was held that the fall in value of the cloth arrived after the season amounted to a deterioration for which the plaintiff was entitled to recover damages without notice.

6. **Damages for Inconvenience and Discomfort**: When a party has suffered physical discomfort and inconvenience as a result of breach of contract, that party can move a suit for claiming compensation. However, according to the general rule, the motive or the manner of breach do not affect the measure of damages.

   Examples

   a) A was wrongfully dismissed in a harsh and humiliating manner by G from his employment. Held, a) A could recover a sum representing his wages for the period of notice and the commission which he would have earned during that period, b) He could not recover anything for his injured feelings or for the loss sustained from the fact that his dismissal made it more difficult for him to obtain employment (**Addis v. Gramaphone Co. Ltd.**).

   b) H, with his wife and children took a ticket for a midnight train, to be transported to a particular place where he lived. They were, however, transported to a wrong place and they had to walk several miles on a drizzling night. H was awarded compensation for inconvenience but nothing for the medical expenses of his wife who caught cold, as this consequence was too remote (**Hobbs v. London & S.W. Pail & Co.**).

7. **Liquidated Damages and Penalty**: Some time, in order to avoid delay in the assessment and payment of damages, at the time of formation of contract, the parties to a contract mutually agree to stipulate or specify sum, which will become payable by the party guilty of breach. If the specified sum represents a fair and genuine pre-estimate of the damages likely to result due to breach, then it is called **liquidated damages**. On the other hand, if the sum fixed at the time of formation of contract is disproportionate to the damages likely to occur, the sum is deemed to be a **penalty**. The amount is so provided to ensure performance of the contract.

   Under English law, liquidated damages are enforceable but penalty cannot be claimed. In India, however, there is no such distinction recognised between penalty and liquidated damages. The courts in India allow only 'reasonable compensation' (section 74).

8. **Stipulations for interest**: The largest number of cases decided under section 74 relate to stipulation in a contract providing for payment of interest:

   i) **Payment of interest in case of default**: A stipulation for payment of interest in case of default is not in the nature of a penalty, if the interest is reasonable. If the court finds that the rate of interest is exorbitant and is penal in character it may grant some relief.

ii) **Payment of interest at higher rate**: Such a stipulation occurring in a contract may be of a two fold character:

a) It may either provide for payment of interest at an increased rate from the date of the contract on failure of the debtor to pay on the due date the interest or principal or an instalment of principal; or

b) It may provide for payment at a higher rate from the date of default only.

A stipulation for increased interest from the date of the bond, and not from the date of default is always in the nature of a penalty, and relief may be granted to the party. The court may award only reasonable compensation (**Rameshwar Pd. Singh v. Rai Sham Kishen**). Thus, where a loan is advanced at 15% p.a. with a stipulation that in case of default in payment of any instalment, interest shall be raised to 20% p.a such a stipulation is a penalty and court may award reasonable compensation only.

A stipulation for increased interest from the date of default may be stipulation by way of penalty. When it is so, relief is granted against it. Whether such a stipulation is penal or not depends on the terms of the contract and the circumstances of each case. For example, A gives B a bond for repayment of Rs. 10,000 with interest @ 12% at the end of six months, with a stipulation that in case of default, interest shall be payable @ 75% from the data of default. This is a stipulation by way of penalty and B is only entitled to recover from A such compensationas as the court considers reasonable.

iii) **Payment of Compound Interest on Default:** A stipulation in a bond for payment of compound interest on failure to pay simple interest at the same rate as was payable upon the principal is not a penalty. But a stipulation in a bond for the payment of compound interest at a rate higher than that of simple interest is a penalty and the party may be relieved against.

9. **Forfeiture of 'Earnest Money' or 'Security Deposit'**: The amount deposited as security for performance of a contract and the same is supposed to be adjusted against the price on completion of the contract, is called earnest money. Is a clause in a contract providing for forfeiture of earnest money in the event of failure to perform in the nature of penalty? In a number of judicial decisions, it has been held that such a clause shall be in the nature of a penalty and only reasonable compensation could be claimed. (**Mohd. Sultan v. Naina Mohd, M/s Variety Body Builders v. Union of India, Fateh Chand v. Balkishan Dass**).

10. Mitigation of damages explanation to section 73 provides for duty to mitigate the damages. The injured party has to see that his loss to kept to the minimum.

8.3.3 Suit for Specific Performance

In certain cases of breach of contract, damages may not be considered as an adequate remedy. The aggrieved party may not be interested in monetary

compensation. The court may, in such cases, direct the defaulting party to carry out the promise according to the terms of the contract. This is called 'Specific Performance' of the contract.

Specific performance of a contract may, at the discretion of the Court, be enforced where the contract involves the sale of a particular house or some rare article 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. For example, A agreed to sell an old painting to B for Rs. 10,000. Subsequently, A refused to sell the painting. Here, B may file a suit against A for the specific performance of the contract.

Specific performance is not granted under the following situations:

a) When monetary compensation is an adequate relief.

b) When the contract is of a personal nature, e.g., a contract to marry, a contract to paint a picture, etc. In such contracts injunction is granted in place of specific performance.

c) Where it is not possible for the court to supervise the performance of the contract, e.g., a building construction contract.

d) When the contract is made by a company beyond its powers as laid down in its memorandum of association.

e) When the contract is inequitable to either party.

f) Where one of the parties is a minor.

8.3.4 Suit for Injunction

Where a party is in breach of a negative term of a 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. Such an order issued by court is called an 'injunction'.

Examples

1. G agreed to buy the whole of the electric energy required for his house from a certain company. He was, therefore, restrained by an injunction from buying electricity from any other person. (**Metropolitan Electric Supply Company v. Ginder**).

2. W agreed to sing at L's theatre, and during a contract period to sing nowhere else. Afterwards, W made contract with Z to sing at another theatre and refused to perform the contract with L. Held, W could be restrained by injunction from singing for Z (**Lumely v. Wagner**).

8.3.5 Suit upon 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, he cannot claim performance from the other. To this rule, however, there are certain exceptions on the basis of quantum meruit. When a person has done some work under a contract and the other party repudiates the contract, or some event happens which makes the further performance of the contract impossible, then the party who has already performed the work can claim

payment for the work he has already done. **This right of claiming the payment for work already done, before the repudiation of the contract or its further performance becoming impossible is called the right to quantum meruit**. For example, X, a writer, was engaged by M who is the editor of a magazine to write a series of twelve articles to be published in the magazine. After X had delivered six articles, the publication of the magazine was discontinued. X is entitled to receive payment for the six articles already written. You will study more about quantum meruit later in this unit.

Check Your Progress A

1. What is a breach of contract?

    ....

    ....

    ....

2. What is an anticipatory breach of contract?

    ....

    ....

    ....

3. State whether the following statements are True or False.

    i) Special damages are available as a matter of statutory right.

    ii) Special damages cannot be claimed unless extraordinary circumstances resulting in a special loss were communicated to the promisor.

    iii) Exemplary damages are available only in case of defamation, like wrongful dishonour of a cheque by a bank.

    iv) In India, although liquidated damages are allowed, penalty provision in a contract is void.

    v) The promisee has a right to refuse to accept monetary compensation and insist on specific performance of a contract by the promisor.

4. Fill in the blanks :

    i) The rule on special damages was for the first time laid down in the case of ....

    ii) The measure of ordinary damages is the difference between price .... and the price.

    iii) Speciftic performance of a contract will not be granted where the contract is of a ....

    iv) Quantum Meruit means ....

    v) Actual breach of a contract may take place (a) at the time when performance is due, or (b). ....

8.4 QUASI CONTRACTS

There are many situations in which a person may be required to conform to an obligation, although he has neither broken any contract nor committed any tort. For example, A has forgotten certain articles in B's house. Now B is bound to restore them to A. Such obligations are generally described as 'quasi contractual obligations'.

Quasi contracts are based on the principle of equity and justice. It simply states that nobody shall enrich himself unjustly at the expense of another. In fact, a quasi contract is not a contract at all. It is an obligation which the law creates in the absence of any agreement, when the acts of the party or others have placed in the possession of one person, money or its equivalent under such circumstances that in equity and good conscience, he ought not to retain it, and which in justice and fairness belongs to another. He then is placed under an obligation to restore or repay for such a benefit.

8.4.1 Definitions of Quasi Contracts

There is no statutory definition of a quasi contract available either under the English Law or under the Indian Contract Act. Pollock describes quasi contracts as "**contracts 'in law' but not 'in fact', being the subject matter of a fictitious extension of the sphere of the contract to cover obligations which do not in reality fall within it**". Sir William Anson, a noted English author points out that "circumstances must occur under any system of law in which it becomes necessary to hold one person to be accountable to another, without any agreement on the part of the former to be so accountable, on the ground that otherwise he would be retaining money or some other benefit which has come into his hands to which the law regards the other person as better entitled, or on the ground that without such accountability, the other would unjustly suffer loss. The 'Law of Quasi Contract' exists to provide remedies in circumstances of this kind."

Quasi contracts are also called *implied contracts*. They are implied because they create such obligations which resemble those created by contracts. The essentials for the formation of a contract are absent but as outcome resembles those created by a contract they are called quasi contracts. Under English Law, they are also termed as *Constructive Contracts or Contracts in Law*, etc. Under Indian Contract Act quasi contracts are called *"certain relations resembling those created by contracts"* and are found under sections 68 to 72.

8.4.2 Difference Between Quasi Contracts and Contracts

In case of contracts, it is the consent of the party which produce the obligations. But in quasi contracts there is no question of consent, it is the law alone or natural equity which produces obligations. As noted earlier, a quasi contract is based on the ground that a person shall not be allowed to unjustly enrich himself at the expense of another. There is, however, similarity between quasi contract and contracts in case of claims for damages. In case of breach of a quasi contract section 73 of the Indian Contract Act provides for the same remedies (claim for damages) as provided in case of breach of a contract. It reads: *When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure*

to discharge it is entitled to receive the same compensation from the party in default, as if such person has contracted to discharge it and has broken his contract.

8.4.3 Types of Quasi Contracts

You have studied what is a quasi contract and how it differs from a contract. Now, let us look into various kinds of quasi contracts recognised under the Indian Contract Act. Sections 68 to 72 deal with five types of quasi contractual obligations.

Supply of Necessaries

According to section 68, if a person incapable of contracting (which would include a minor, idiot an d lunatic) or anyone whom he is legally bound to support, is supplied by another with 'necessaries' suited to his condition in life such person is entitled to recover the value thereof from the property of such incapable person. You should note that the aforesaid claim for necessaries is based upon quasi contractual obligations because a contract with a person incompetent to contract is void-ab-initio. The following two points must, however, be noted in this regard:

a) The amount is recoverable only from the property (if any) of the incapable person and not from him personally.

b) The goods or services supplied must be 'necessaries'. For details and case law, you may refer to the discussion on 'contracts with a minor' in Unit 3, Block 1 of this course.

Payment of money due by Another (Section 69)

A person, who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other.

Example: B holds land in Bengal on a lease granted by A, the Zamindar. The revenue payable by A to the Government being in arrears, his land is advertised for sale by the Government. Under the revenue law, the consequences of such sale will be annulment of B's lease. B, to prevent the sale and consequent annulment of his own lease, pays to the Government the sum due from A. A is boud to make good to B the amount so paid (**Hazarilal v. Naurang Lal**).

For the section 69 to apply, the following essentials must be met:

i) The person paying must be himself interested in making the payment. Thus, where P left his carriage on D's premises and D's landlord seized the carriage for non-payment of the rent. P paid the rent to obtain the release of his carriage. Held, P could recover the amount from D (**Exall v. Patrige**).

ii) The payment should not be voluntary one.

iii) The payment must be such as the other party was bound by law to pay.

Example: The goods belonging to A were wrongfully attached in order to realise arrears of Government revenue due by G. A paid the amount to save the goods

from sale. *Held* he was entitled to recover the amount from G (**Abid Hussain v. Ganga Sahai**).

Obligations to Pay for Non-gratuitous Acts (Section 70)

Where a person lawfully does anything for another person or delivers anything to him not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered.

Examples: i) A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. He is bound to pay A for them. ii) A saves B's property from fire. A is not entitled to compensation from B, if the circumstances show that he intended to act gratuitously.

Under section 70, three conditions are required to establish a right of action at the suit of a person who does anything for another.

i) The thing must be done lawfully.

ii) It must be done by a person not intending to act gratuitously.

iii) The person for whom the act is done must enjoy the benefit of it.

Contracts required to be in writing: you should note that where there is a mandatory provisions is an act requiring contracts to be in writing, an oral contract is void. But it has been held by the Supreme Court that where work has been done and accepted, Section 70 is applicable and payment should be made for the work done. (**State of West Bengal v. B. K. Mandal & Sons**).

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Responsibility of a Finder of Goods

A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee. In such a case, an agreement is implied by law between the owner and finder of goods and the latter is deemed to be a bailee. A finder is, thus, bound to take as much care of the goods found as a man of ordinary prudence would under similar circumstances take of his own goods of the same bulk, quantity and value. Besides, he must make reasonable efforts in finding the real owner.

Rights of the Finder of Goods: A finder of goods has the following rights:

1. The finder is entitled to retain the goods against the whole world, except the true owner. For examples, A picked up a diamond from the floor of B's shop and handed it over to B to keep it till the owner is found. In spite of best efforts, the true owner could not be found. After some time, A tendered to B the lawful expenses incurred by him for finding the true owner and asked him to return the diamond to him (A). B refused to do so. Held B must return the diamond to A as A was entitled to retain it against the whole world, except the true owner (**Hollins v. Fowler**).

2. The finder has lien in respect of any sum which may be due to him on account of expenditure incurred by him in respect of the goods (section 168).

3. Where the owner has offered a specific reward for the return of goods lost, the finder may sue for such reward, and may retain the goods until he receives it (section 168). This right was re-endorsed in the case of **Harbhajan v. Harcharan**.

4. The finder may sell the goods in the following circumstances :

   a) Where the thing found is in danger of perishing.

   b) Where the owner cannot, with reasonable diligence, be found out.

   c) Where the owner has been found but he refuses to pay the lawful charges of the finder.

   d) Where the lawful charges of the finder, in respect of the thing found amount to 2/3rd or more of the value of the thing found.

Liability of Person to whom Money is Paid or Thing Delivered by Mistake or under Coercion

A person to whom money has been paid, or anything delivered by mistake or under coercion, must repay or return it (section 72).

Example

1. A and B jointly Owe Rs.100 to C. A alone pays the amount to C. Not knowing this fact, B pays Rs. 100 again to C. Now, C is bound to repay the amount to B.

2. A railway company refuses to deliver certain goods to the consignee, except upon the payment of illegal charges. The consigner pays the sum charged in order to obtain the goods. He is entitled to recover so much of the charge as was illegally excessive.

You should note that section 72 is based upon the principle of equitable restitution. A person is under a mistake that money is due when, in fact, it is not due. Such a person when he pays under mistake must be repaid. Money paid under mistake is recoverable whether the mistake be of fact or of law. In the case of **Sales Tax Officer v. Kanhaiya Lal** the Supreme Court held that section 72 of the Indian Contract Act is wide enough to cover not only a mistake of fact but also a mistake of law. In this case, the levy of sales tax on forward transactions was held to be *ultra vires* by the Allahabad High Court. The respondent, therefore, claimed a refund of the tax paid under mistake of law under section 72. It was held that the respondent was entitled to the refund.

With reference to the word 'coercion' used in this section, it may be noted that the word is to be interpreted in its popular sense to mean oppression, extortion or such other means **(Seth Kanhaiya La1 v. National Bank of India).**

8.5 QUANTUM MERUIT

As discussed earlier, the phrase 'quantum meruit' means 'as much as merited' or 'as much as earned'. The general rule of law is that unless a person has performed his obligations in full, he cannot claim performance from the other **(Cutter v. Powell).**

But, in certain cases, when a person has done some work under a contract, and the other party repudiates the contract or some event happens which makes the further performance of the contract impossible then the party who has performed the work can claim remuneration for the work he has already done. The right to claim on 'quantum meruit' does not arise out of the contract as the right to damages does. It is a claim on the quasi contractual obligations which the law implies in the circumstances **(Patel Engg. Co. Ltd. v. Indian Oil Corporation Ltd.).** The action of 'Quantum Meruit' is allowed in Indian Courts under section 70 of the Contract Act.

The claim of 'Quantum Meruit' arises in the following cases :

1. **When a contract is discovered to be unenforceable**: When an agreement is discovered to be void or becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it. For example, A, a singer, contracts with B, the Manager of a theatre to sing at his theatre for two nights every week during the next two months. and B agrees to pay her Rs. 1,000 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B must pay A for the five nights on which she had sung.

2. **When one party abandons or refuses to perform the contact**: Where there is a breach of contract, the aggrieved party is entitled to claim reasonable compensation for what he has done under the contract. For example, C, an owner of a magazine engaged P to write a book to be published by instalments in his magazine. After a few instalments were published, the publication of the magazine was stopped. Held, P could claim payment on quantum meruit for the part already published. (**Planche v. Colburn**). In another case S, a building contractor agreed to construct a house for H for $565. He did work to the extent of $333 and then abandoned the contract. Afterwards, H gets the work completed by another person. Then S cannot recover anything for the work done because he was entitled to the payment only on the completion of the work **(Sumpter v. Hedges).**

3. **When a Contract is divisible**: When a contract is divisible and the party not in default has enjoyed 'benefit of the part performance, the party in default may sue on a quantum meruit. But if the contract is not divisible, the party in default, cannot claim compensation on this basis.

4. **When an indivisible contract is completely performed but badly**: 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. For example, A agreed to decorate B's flat for a lump sum of Rs.10,000. A did the work but B complained of faulty workmanship. It costs B Rs. 2,000 to remedy the defect. A shall be entitled to recover from B Rs. 8,000 (Rs.10,000-Rs. 2,000) (**Hoeing v. Isaac**).

Check Your Progress B

1. Distinguish between a contract and a quasi contract.

   ....

   ....

2. What do you understand by Quantum Meruit?

 ....

 ....

 ....

3. Fill in the blanks:

   i) The alternative expression for 'Quasi Contracts' is ....

   ii) The property of a minor may be attached for .... supplied to him.

4. State whether the followings statements are True or False:

   i) Minor's properties may be attached for necessaries supplied to his dependant.

   ii) A person cannot recover from another an amount paid under a mistake of law.

   iii) One cannot claim performance from another unless one has carried out his part of the promise in full.

   iv) Finding is keeping.

   v) A finder is the next best owner to the real owner.

8.6 LET US SUM UP

When one of the parties fails or refuses to perform his part of the promise, he is said have committed a breach of contract. In such a case the other party, called the aggrieved party, has certain remedies. These remedies include: (1) right of rescission (that is right not to perform), (2) right to claim damages (including ordinary ,damages, special damages, exemplary or vindictive damages, nominal damages, liquidated damages and penalty), (3) suit for specific performance, (4) suit for injunction (stay order), and (5) suit on Quantum Meruit basis.

There are certain obligations/ rights which are not contractual but they resemble contractual obligations/rights. Law, therefore, on principle of equity, treats them as contracts. Such situations are more commonly known as quasi contracts. Various types of quasi contracts are dealt with under sections 68 to 72 of the Indian Contract Act. These include: (1) claim for necessaries supplied to a person incapable of contracting or on his account, (2) reimbursement of person paying money due by another in payment of which he is interested, (3) obligation of person enjoying benefit of non-gratuitous act, (4) responsibility of finder of goods, and (5) liability of person to whom money is paid or thing delivered by mistake or under coercion.

8.7 KEY WORDS

Anticipatory Breach: Breach of a contract before its performance is due.

Damages: Monetary compensation granted to a party by the court in the event of a breach of a contract by the other party.

Exemplary Damage: Damages awarded to create an example.

Frustration: A term used in English Law for the term 'supervening impossibility' in Indian Law.

Injunction : An order of the court prohibiting a person to do a particular act commonly known as 'Stay Order'.

Penalty: The amount of compensation payable in case of breach and stated in the contract.

Punitive: In the nature of punishment.

Quasi Contracts: In the nature of contracts or similar to contracts.

Quantum Meruit: Quantity merited or 'as much as earned'.

Rescission: Right not to perform a contractual obligation.

8.8 ANSWERS TO CHECK YOUR PROGRESS

A) 3. i) False ii) True iii) False iv) False v) False

4. i) Hadley v. Baxendale ii) Market, contracted iii) personal nature

iv) as much as earned v) during the performance of a contract.

B) 3. i) Certain relations resembling those created by contracts.

ii) Section 68 of the Indian Contract Act.

4. i) True ii) False iii) True iv) False v) True.

8.9 TERMINAL QUESTIONS

1. What do you understand by anticipatory breach of contract'? State the legal position of the parties in such a case.
2. What are the rules under the Indian Contract Act for estimating the loss or damage arising from a breach of contract?
3. What is 'Breach of Contract? What remedies are available to an aggrieved party on the breach of a contract?
4. "Compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach of contract". Discuss.
5. Explain the terms 'Penalty' and 'Liquidated Damages' clearly indicating the difference between the two.
6. What are the quasi contracts? Enumerate the type of such contracts dealt within the Indian Contract Act.
7. Write a short note on 'Quantum Meruit'.

Note: These questions and exercises will help you to understand the unit better. Try to write answers for them. But do not send your answers to the University. These are for your practice only.

SOME USEFUL BOOKS

M. C. Kuchhal, and Vivek Kuchhal, Business Law, Vikas Publishing House, New Delhi.

Avtar Singh, Business Law, Eastern Book Company, Lucknow.

S. N. Maheshwari and SK Maheshwari, Business Law, National Publishing House, New Delhi.

G. K. Kapoor Business Laws, Scholar Tech Press, New Delhi.

P. C. Tulsian and Bharat Tulsian, Business Law, McGraw Hill Education.

Sharma, J. P. and Sunaina Kanojia, Business Laws, Ane Books Pvt. Ltd., New Delhi.

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SPECIFIC CONTRACTS

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BLOCK 3 SPECIFIC CONTRACTS

In Block 1 and 2 you have learnt about the general law of contract which is applicable to all types of contracts. For certain contracts, however, the Contract Act has laid down special rules. Such contracts are: contract of indeimnity and guaratnee, contract of bailment and pledge and contract of agency. In this block you will study detailed rules relating to these specific contrats.

Unit 9 deals with contract of indemnity and guarantee and discusses their meaning, their differences, the rights of indemnity holder, the rights of surety, and the discharge of surety's liability.

Unit 10 deals with contracts of bailment and pledge and discusses their meaning, their differences, the rights and duties of bailer and bailee, the rights and duties of pawnor and pawnee, the termination of bailment, and the pledge by non-owner.

Unit 11 deals with contract of agency. It describes the meaning of agency, modes of creating agency, scope and extent of agent's authority, rights and duties of an agent, liability of principal to third party, and the termination of agency.

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UNIT 9 INDEMNITY AND GUARANTEE

Structure

9.0 Objectives

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9.2 Meaning of Contract of Indemnity

9.3 Rights of Indemnity Holder

9.4 Commencement of Indemnifier's Liability

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9.6 Distinction between Contract of Indemnity and Contract of Guarantee

9.7 Extent of Surety's Liability

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9.0 OBJECTIVES

After studying this unit, you should be able to:

- define a contract of indemnity;
- describe the rights of indemnity holder;
- define a contract of guarantee;
- distinguish between a contract of indemnity and a contract of guarantee;
- explain the extent of surety's liability;
- describe the rights of surety; and
- explain when a surety is discharged.

9.1 INTRODUCTION

You have so far studied the principles applicable to contracts in general. Let us now take up a particular species of contract viz., Contracts of Indemnity and Contracts of Guarantee. Since these are specific types of contract, the general principles of contracts are fully applicable to such contracts. In this unit you will learn the meaning of contract of indemnity, right of indemnity-holder, and commencement of indemnifier's liability. You will also study the meaning of contract of guarantee, the difference between contract of indemnity and guarantee, types of guarantees, rights of a surety, and discharge of surety from liability.

9.2 MEANING OF CONTRACT OF INDEMNITY

The term 'indemnity' simply means to make good the loss or to compensate the party who has suffered some loss. The term 'contract of indemnity' is defined in Section 124 of the Indian Contract Act as follows, **"A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself or by the conduct of any other person, is called a contract of indemnity."** The person who promises to compensate for the loss is called the "indemnifier" and the person to whom this promise is made or whose loss is to be made good is known as "indemnity-holder" or "indemnified". For example, A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of money. This is a contract of indemnity, here A is the indemnifier and B is the indemnified.

The above definition in not exhaustive and restricts the scope of contracts of indemnity as it covers only the losses caused by the conduct of the promisor himself or by the conduct of any other person. If a strict view is taken of this definition, it will exclude the losses caused by accidents and events not depending upon the conduct of the promisor or any other person. In that case insurance contracts should not fall within the purview of contracts of indemnity. But the fact is that all contracts of insurance (except life insurance) are also contracts of indemnity. The intention of law makers had never been to exclude insurance contracts from the purview of contracts of indemnity. That is why we follow the English definition which states "**a promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor**". This definition includes a promise to make good the loss arising from any cause whatsoever e.g. fire, perils of sea, accidents etc.

A contract of indemnity may be express or implied. when a person expressly promises to compensate the other from loss, it is termed as express indemnity. The contract of indemnity is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case. Even Section 69 of the Contract Act (discussed in Unit 8) implies a duty to indemnity in case a person who is interested in the payment of money which another is bound by law to pay, has paid the amount. Similarly, in an auction sale there is an implied contract of indemnity between the auctioneer and the person who asks him to sell goods. For example, A, an auctioneer, sold certain goods on the instructions of B. Later on, it is discovered that the goods belonged to C and not B. So, C recovered damages from A for selling the goods belonging

to him. Here A is entitled to recover the compensation from B. In this case there was an implied promise to compensate the auctioneer for any loss which he may suffer on account of the defective title of B.

As you know that contract of indemnity is a special type of contract, therefore, to enforce such contracts it is necessary that all the essentials of a valid contract (discussed in Unit 1) must be present. In case any one of the essential is missing, the contract cannot be enforced. Thus if the object or consideration of an indemnity agreement is unlawful, it cannot be enforced. For example, A asks B to beat C, promising to indemnify him against the consequences, this cannot be enforced. Suppose B beats C and is fined Rs. 500, B cannot claim this amount from A, because the object of the agreement is unlawful

9.3 RIGHTS OF INDEMNITY HOLDER

In pursuance of Section 125 of the Act the indemnity-holder may recover from the indemnifier (promisor), the following amounts, provided he acts within the scope of his authority :

1) He is entitled to recover all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applied.

2) He is entitled to recover from the indemnifier all costs which he had paid in bringing or defending any suit in respect of contracts of indemnity. In bringing or defending the suit the indemnity-holder must not contravene the orders of the indemnifier and he must act in the same way as a prudent man would have acted under similar circumstances in his own case.

3) He is entitled to recover from the indemnifier, all the amount which he had paid under the terms of the compromise of such suit. However, it is essential that the compromise must not be contrary to the orders of the indemnifier and in compromising the suit, he must act as a prudent man. This right is also available to the indemnity-holder when he paid any amount under any compromise entered by him and authorised by the indemnifier.

9.4 COMMENCEMENT OF INDEMNIFIER'S LIABILITY

An important question in this connection is when does the indemnifier become liable to pay, or, when is the indemnity-holder entitled to recover his indemnity? The indemnity-holder is entitled to above-mentioned rights as soon as his liability has become certain although he has himself paid nothing. **Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay**. Thus, if the indemnity-holder has incurred an absolute liability, he is entitled to ask the indemnifier to save him from that liability and pay it off. In simple words, the liability of indemnifier commences as soon as the liability of the indemnity-holder becomes absolute .

Check Your Progress A

1. Define a contract of indemnity.

    ....

    ....

    ....

2. A contract of indemnity is a contingent contract. Do you agree?

    ....

    ....

    ....

3. The definition of contract of indemnity as given in the Contract Act includes implied promises to indemnify. Is it true?

    ....

    ....

    ....

4. A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of money. C obtains judgement against B for the amount. Without paying any portion of the decree amount, B sues A for its recovery, will he succeed?

    ....

    ....

    ....

5. A person asks another of beat a third person, promises to indemnify him against consequences. Can this be enforced?

    ....

    ....

    ....

    ....

9.5 MEANING OF CONTRACT OF GUARANTEE

The object of contract of guarantee is to enable a person to obtain an employment, a loan or goods on credit.

According to Section 126 of the Indian Contract Act, *'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 person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called 'the principal debtor'; and the person to whom the guarantee is given is called 'the creditor'*. A guarantee may be either oral or written. For example, if A, and his friend B enter a trader's shop, and A asks the trader, "supply the articles required by B, and if he does not pay you, I will."

It is a contract of guarantee. The primary liability to pay is that of B but if he fails to pay, A becomes liable to pay. On the other hand, if A says to the trader, "let him (B) have the goods, 1 will see you are paid", the contract is one of indemnity and not a contract of guarantee.

From the above-mentioned definition of guarantee you will notice that in a contract of guarantee, there are three parties known as creditor, principal debtor and surety. A contract of guarantee is formed when all the three agree. Let us take an example, A and B enter in a shop, and A orders to deliver certain goods to B on credit, the shopkeeper says "I can give goods on credit provided A gives the guarantee for the payment". A promises to guarantee the payment. In this example, B is the principal debtor, A is the surety and the shopkeeper is the creditor and the contract is a contract of guarantee.

A contract of guarantee is an agreement and as such all the essentials of valid contract must be present. For instance, the contracting parties should be competent to contract. Suppose in the above-mentioned example B is a minor i.e., incompetent to contract. In such a situation A would be regarded as the principal debtor and he will become personally liable to pay. Thus, the incapacity of the principal debtor does not affect the validity of a contract of guarantee. The requirement is that the creditor and the surety must be competent to contract.

Now you may ask that if a contract of guarantee should have all the essentials of a contract then what is the consideration between surety and the principal debtor. It is not necessary that there should be direct consideration between the surety and the creditor i.e., the surety need not be benefited. It is sufficient (for the purposes of consideration) that something is being done or some promise is made for the benefit of principal debtor. It is presumed that the consideration received by principal debtor is the sufficient consideration for the surety. You would appreciate it if you go through the provision of Section 127, which says: *Any thing done, or any promise made for, the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.*

On examining the definition of contract of guarantee, you would find that as there are three parties, there are three contracts as well. One contract is between the creditor and the principal debtor, out of which the guaranteed debt arises. Second contract is between the surety and the principal debtor who implies that the principal debtor shall indemnify the surety, if the principal debtor fails to pay and the surety is asked to pay. The third contract is between the surety and the creditor by which surety undertakes (guarantees) to pay the principal debtor's liabilities (debt) if the principal debtor fails to pay.

For a valid contract of guarantee, it is essential that there must be an existing debt or a promise whose performance is guaranteed. In case there is no such debt or promise, there can be no valid guarantee. In fact, a contract of guarantee pre-supposes the existence of a liability enforceable by law. For example, A gives the guarantee to B for the payment of a time-barred debt due from C. This is not a valid contract of guarantee because the primary liability between B and C is not enforceable by law. In case A pays the amount, he cannot recover it from C.

An interesting aspect of the contract of guarantee is that though it is not a contract of *uberritnae fidei* (a contract of absolute good faith) and therefore, it is not

necessary for the principal debtor or the creditor to disclose all the material facts to the surety before he enters into a contract. However, the facts which are likely to affect the surety's decision must be truly represented to him. Section 142 of the Act provides that *any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid*.

You should also note that not only there should be no misrepresentation but it is also essential that the guarantee must not be obtained by concealing some facts. Section 143 provides that **any guarantee which the creditor has obtained by means of keeping silence to material circumstances is invalid**. For example, A employs B as clerk to collect money for him. B fails to account for some of his receipts, and A, in consequence, calls upon him (B) to furnish security for his duly accounting. C gives the guarantee for B's duly accounting. A did not inform C about B's previous conduct. B, afterwards, makes default. Here the guarantee given by C is invalid because it was obtained by concealment of facts by A.

From this discussion, let us summarise the essential features of a contract of guarantee as follows:

i) It may be express or implied

ii) Existence of a debt, for which some person other than the surety should be primarily liable.

iii) Consideration, but it is not necessary that the surety should be benefited.

iv) All the essentials of a valid contract should be present.

v) Creditor and surety must be competent i.e., principal debtor need not be Competent to contract.

vi) Surety's liability is dependent on principal debtor's default.

vii) Guarantee must not be obtained by misrepresentation.

viii) Guarantee must not be obtained by concealment of material facts.

9.6 DISTINCTION BETWEEN CONTRACT OF INDEMNITY AND CONTRACT OF GUARANTEE

Following are the main points of difference between a contract of indemnity and contract of guarantee.

i) In a contract of indemnity there are only two parties i.e., indemnifier and the indemnified while in a contract of guarantee there are three parties principal debtor, creditor and the surety.

ii) In a contract of indemnity there is only one contract, whereas in a contract of guarantee, there are three contracts.

iii) In a contract of indemnity the indemnifier undertakes to save the indemnified from any loss caused to him by the conduct of indemnifier himself or the conduct of any other person, while in a contract of guarantee, the surety undertakes for the payment of debts of principal debtor, if the principal debtor fails to pay it.

iv) In a contract of indemnity, the liability of indemnifier is primary and independent, while in a contract of guarantee the liability of surety is secondary i.e., it arises only on the default of principal debtor. The primary liability is that of the principal debtor.

v) In a contract of indemnity, indemnifier's liability arises only on the happening of a contingency, while in a contract of guarantee there is an existing duty or debt, the performance of which is guaranteed by the surety.

vi) In a contract of indemnity, indemnifier acts independently without any request of the debtor or the third party, while in a contract of guarantee the surety guarantees at the request of principal debtor.

vii) In a contract of guarantee, if the principal debtor fails to pay and the surety discharge his debt, the surety can proceed against the principal debtor in his own right, while in a contract of indemnity, the indemnifier cannot sue the third party in his own name unless there is an assignment in indemnifier's favour. If there is no such assignment, the indemnifier must bring the suit in the name of indemnified.

9.7 EXTENT OF SURETY'S LIABILITY

Under section 128 of the contract Act "in the absence of a contract to the contrary, the liability of **surety is co-extensive** with that of the liability of the principal debtor." It means that the surety is liable to the same extent to which the principal debtor is liable. For example, A guarantees to B the payment of a bill of exchange by C, the acceptor. On the due date the bill is dishonoured 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.

You have noted that the liability of the surety is equal to that of the principal debtor. But if at the time of giving the guarantee, the surety has given the guarantee for a fixed amount, in that case the liability of the surety can, in no case, be more than the fixed amount. A surety has the right to limit his liability. For example, A lends Rs. 5,000 to B and C gives the guarantee for Rs. 3,000 only. If B makes a default, C shall be liable only for Rs. 3,000.

It is true that the liability of surety is co-extensive with that of the principal debtor, but it does not mean that if due to some reason the principal debtor cannot be held liable then the surety will also not be liable. This is so because the contract between the surety and the creditor is an independent contract and not a collateral one. For example, when the principal debtor is a minor, the surety is liable. Not only this, if by any act the liability of the principal debtor is reduced or terminated, the surety continues to be liable. If the creditor fails to sue the principal debtor and the debt becomes time barred, the surety continues to be liable.

Though the primary responsibility to pay the debtor or perform the promise is that of the principal debtor, in the absence of a contract to the contrary, the liability of the surety arises immediately when a default is made by the principal debtor. The surety cannot ask the creditor to give a notice of default. The surety cannot even ask the creditor to first exhaust all the remedies open to him against the principal debtor, before taking action against the surety. Thus, the creditor is not bound to proceed first against the principal debtor before suing the surety.

Condition Precedent to Liability

In a contract, if there is a condition precedent for the surety's liability, the surety would only be liable when that condition is fulfilled first. Section 144 of the Act provides for such situations, that *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*. For example, your friend A requires a loan of Rs. 10,000 from the bank. You and two of your friends C and D, agree to guarantee the repayment of loan. C does not sign the necessary documents. You and your friend D are also not liable on this guarantee because it is a condition precedent to your guarantee that the repayment of loan shall be guaranteed by all the three.

In case of a continuing guarantee the surety shall be liable for all such transactions which have taken place upto the time of termination of guarantee. You will learn more about it in subsequent paragraphs.

9.8 KINDS OF GUARANTEE

Contracts of guarantees may be classified into two types: **Specific guarantee and continuing guarantee**. When a guarantee is given in respect of a single debt or specific transaction and is to come to an end when the guaranteed debt is paid or the promise is duly performed, it is called a specific or simple guarantee. However, a guarantee which extends to a series of transactions is called a continuing guarantee (Section 129). The surety's liability in this case would continue till all the transactions are completed or till the guarantor revokes the guarantee as to the future transactions. A fidelity guarantee is a continuing guarantee as it continues for a period of time.

Examples

a) S is a bookseller who supplies a set of books to P, under the contract that if P does not pay for the books, his friend K would make the payment. This is a contract of specific guarantee and K's liability would come to an end, the moment the price of the books is paid to S.

b) On M's recommendation S, a wealthy landlord, employs P as his estate manager. It was the duty of P to collect rent every month from the tenants of S and remit the same to S before the 15th of each month. M, guarantee this arrangement and promises to make good any default made by P. This is a contract of continuing guarantee.

In order to understand continuing guarantee, the following points should be noted:

i) The most important feature of a continuing guarantee is that it applies to a series of separable, distinct transactions. Therefore, when a guarantee is given for an entire consideration, it cannot be termed as a continuing guarantee. For example, K gave his house to S on a lease for ten years on a specified lease rent. P guaranteed that S, would fulfil his obligations. After seven years S stopped paying the lease rent. K sued him for the payment of rent. P then gave a notice revoking his guarantee for the remaining three years. P would not be able to revoke the guarantee because the lease for ten years is an entire indivisible consideration and cannot be classified as a series of transactions. This contract, therefore, cannot be classified as a contract of continuing guarantee.

ii) In deciding whether particular contract of guarantee is a specific guarantee or a continuing one, you will have to see the intention of the parties as expressed by the terms of the contract and the prevailing circumstances. For example, A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C, C pays for them. Afterwards, B delivers four sacks to C for which C does not pay for. Here A cannot be held liable because it is clear from the terms of the contract that A intended to guarantee only for the payment of price of the first five sacks of flour.

iii) A continuing guarantee may be given for a part of the entire debt or for the entire debt subject to a limit. Let us understand this with the help of an example. S gave guarantee for the loans taken from time to time by P from C. P owes rupees ten thousand to C. S, may have given his guarantee in the following two forms.

   a) I guarantee the payment of the debt of rupees five thousand by P to C. This is a case of guarantee only for a part of the entire debt.

   b) I guarantee the payment of any debts of P due to C subject to a limit of rupees five thousand. This is a guarantee for the payment of entire debt subject to a specified limit. You will be wondering as to the distinction between the two forms because in both the cases, S appears to be liable for just five thousand rupees. The distinction becomes clear in the event of insolvency of P, the principal debtor. Let us suppose that P has been declared insolvent and his estate can only repay forty paise in a rupee.

   In the first case when the guarantee is only for a part of the entire debt, C can recover rupees five thousand from S (the guaranteed amount) and Rs.2,000 from P's estate (forty percent of the balance of rupees five thousand). C will, therefore, get Rs. 7,000 in all. After paying five thousand to C, S can claim rupees 2,000 from P's estate. However, when the guarantee is for the entire amount subject to a specified limit, C will recover rupees five thousand from S (upto the guaranteed limit) and Rs. 4,000 from P (forty per cent of the entire debt of Rs. 10,000). S would not be able to claim anything from P's estate till the entire amount of rupees ten thousand has been paid to C.

9.9 REVOCATION OF CONTINUING GUARANTEE

A continuing guarantee may be revoked in any of the following ways:

1) **By Notice of Revocation**: In respect of future transaction the surety may at any time revoke his guarantee by giving a notice to creditor. In such a case, the surety remains liable for the transactions which have already taken place. For example, A guarantees to B to the extent of Rs. 10,000, that C shall pay for all the goods bought by him during the next three months. B sells goods worth Rs. 6,000 to C. A gives a notice of revocation, C is liable for Rs. 6,000. If any goods are sold to C after the notice of revocation, A shall not be liable for that.

2) **By Death of Surety**: Unless there is contract to the contrary, the death of surety operates as a revocation of the continuing guarantee in respect to the transactions taking place after the death of surety.

3) **In the Same Manner in which the Surety is Discharged**: A continuing guarantee is also revoked under all the circumstances under which a surety is discharged from the liability, such as

   i) Novation (Section 62)

   ii) Variance in terms of Contract (Section 133)

   iii) Release or discharge of principal debtor (Section 134)

   iv) When the creditor enters into an arrangement with the principal debtor (Section 135)

   v) Creditor's act or omission impairing surety's eventual remedy (Section 139)

   vi) Loss of Security (Section 141).

These grounds will be explained in 9.11 of this unit, under the heading 'discharge of surety'.

9.10 RIGHTS OF A SURETY

After making a payment and discharging the liability of the principal debtor, the surety gets various rights. These rights can be studied under three heads: (i) rights against the principal debtor (ii) rights against the creditor and (iii) rights against the co-sureties. These have been shown in Figure 9.1 and discussed below in detail1.

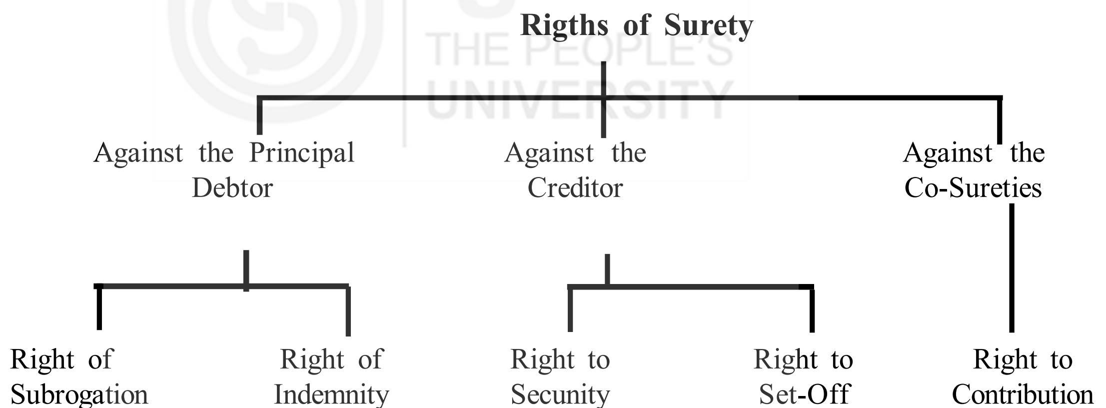

Fig. 9.1

9.10.1 Rights Against the Principal Debtor

The surety has the following two rights against the principal debtor.

1) **Right of subrogation**: The surety acquires all the rights which the creditor had against the principal debtor. Section 140 lays down, *where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor*. This right of the surety is called 'subrogation'. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of creditor.

2) **Right of Indemnity**: Section 145 of the Act vests in the surety another right i.e, right of indemnity. In every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee. The surety is not entitled to claim any sums which he has paid wrongfully.

Examples

i) B is indebted to C, and A is surety for the debt. C demands payment from A and, on his refusal, sues him for the amount, A defends the suit, having reasonable grounds for doing so, but he is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

ii) A guarantees to C, to the extent of Rs. 2,000, payment for rice to be supplied by C to B. C supplies to B rice for an amount which is less than Rs. 2,000 but obtains from A payment of the sum of Rs. 2,000 in respect of the rice supplied. A cannot recover from B more than the rice actually supplied.

9.10.2 Rights Against the Creditor

1) **Right to securities**: When the surety has paid off the liabilities of principal debtor to the creditor, he becomes entitled to claim all the securities which were given by the principal debtor to the creditor. Surety has right to all securities whether received before or after the creation of the guarantee (Section 141). It is also immaterial whether the surety has knowledge of those securities or not. For example, on C's guarantee A lent Rs. 5,000 to B. This debt is also secured by an assignment by deed as security for the debt, the lease of B's house. B defaults in paying the debt and C has to pay the debt. On paying off B's liabilities, C is entitled to receive the assignment deed in his favour.

2) **Right to set off**: When the creditor sues the surety for payment of principal debtor's liabilities, the surety can claim set off, or counter claim if any, which the principal debtor had against the, creditor.

9.10.3 Rights Against the Co-sureties

When the repayment of debt to the principal debtor is guaranteed by more than one person, they are called Co-sureties. **The co-sureties are liable to contribute, as agreed,** towards the payment of guaranteed debt. Section 138 provided that *where there are co-sureties, the release by the creditor of one of them does not discharge the others, nor does it free the surety so released from his responsibility to the other sureties*. Thus when the payment of a debt or performance of duty is guaranteed by co-sureties and the principal debtor has defaulted in fulfilling his obligation and thereupon the creditor compels only one or more of the co-sureties to perform the whole contract, the co-sureties performing the contract are entitled to claim contribution from the remaining co-sureties. According to Section 146, *in the absence of any contract to the contrary, the co-sureties are liable to contribute equally.* This principle will apply even when the liability of co-sureties is joint or several, and whether under the same or different contracts, and whether with or without the knowledge

of each other. For example A, B, C and D are co-sureties for a debt of Rs. 2,000 lent by Z to R. R defaults in repaying the loan. A, B, C and D are liable to contribute Rs. 500 each.

According to Section 147 *where the co-sureties have agreed to guarantee different sums, they have to contribute equally subject to the maximum of the amount guaranteed by each one. It is immaterial whether sureties are liable jointly or severally, under one contract or under independent contracts and with or without the knowledge, of each other*. For example, A, B and C as sureties for D, enter into three separate bonds, each in a different penalty, viz., A for Rs. 10,000, B for Rs. 20,000 and C for Rs. 40,000. D makes default to the extent of Rs. 30,000. A, B and C are liable to pay Rs. 10,000 each. Suppose this default was to the extent of Rs. 40,000. Then A would be liable for Rs. 10,000 and B and C Rs. 15,000 each.

Check Your Progress B

1. Define a contract of guarantee.

   ....

   ....

   ....

2. What is a continuing guarantee?

   ....

   ....

   ....

3. State whether the followings statements are True or False:

   i) An oral guarantee is not guarantee at all. ( )

   ii) In a contract of guarantee, the surety (indemnifier) assumes a primary liability.

   iii) A contract of guarantee is not a contract of '*unberrimae fidei*'. ( )

   iv) The surety by paying the debt to the creditor cannot sue the debtor later. ( )

   v) A continuing guarantee can never be revoked. ( )

4. Fill in the blanks:

   i) If there is no debt, there can be .... valid guarantee.

   ii) Anything done or any promise made for the benefit of the principal debtor may be sufficient .... to the surety for giving the guarantee.

   iii) Guarantee obtained by misrepresentation is ....

   iv) The liability of surety is co-extensive with that of the .... unless it is otherwise provided by the contract.

5. Attempt the following cases, giving reasons for your answer:

   i) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that, if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. Is there sufficient consideration for C's promise?

   ii) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. State whether the agreement is valid.

   iii) A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. State the position of A .

9.11 DISCHARGE OF SURETY FROM LIABILITY

Under any of the following circumstances a surety is discharged from his liability:

i) by revocation of the contract of guarantee,

ii) by the conduct of the creditor, or

iii) by the invalidation of the contract of guarantee

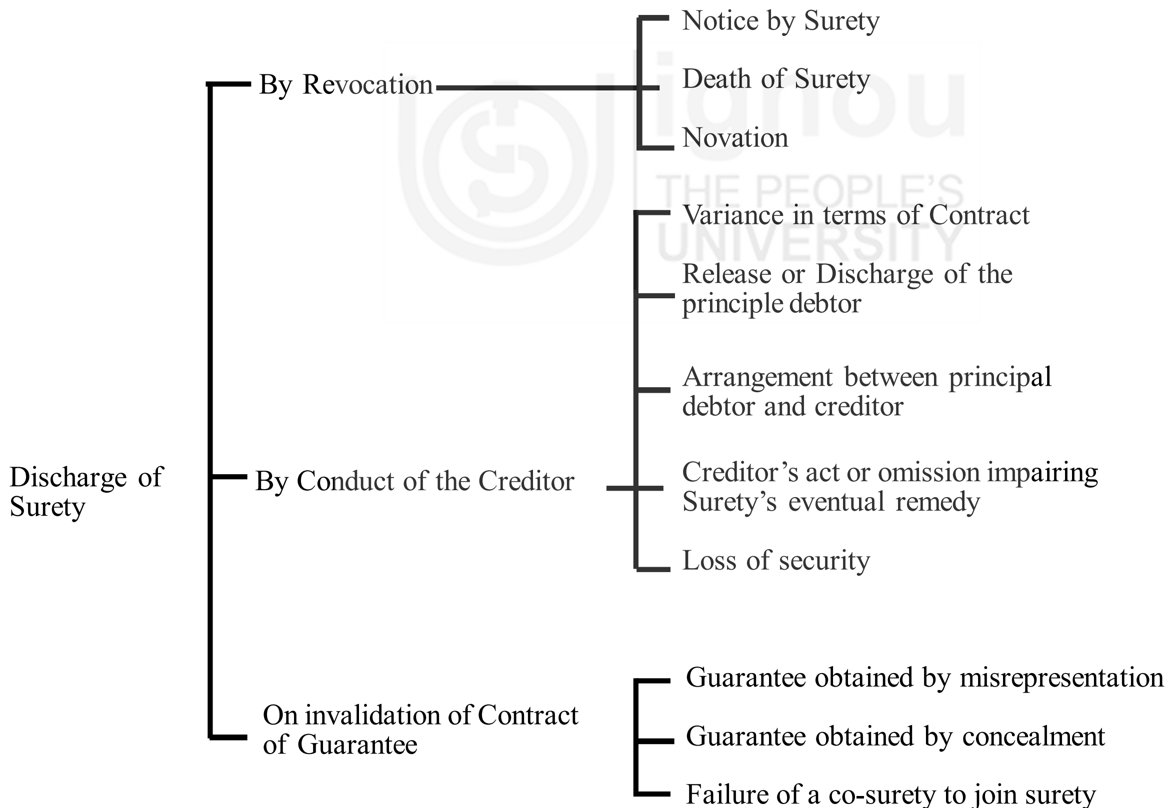

Fig. 9.2: Discharge of Surety

9.11.1 By Revocation of the Contract of Guarantee

i) **Notice by surety**: You have learnt that a contract of guarantee may be specific or continuing. A specific guarantee cannot be revoked if the liability has already accrued. Thus, if A lends B a certain sum of the guarantee of C, then C cannot revoke the contract of guarantee. But, if A has not

yet given the sum to B, even though the guarantee has been executed by C, C may revoke the contract by giving notice.

Where the guarantee is a continuing one and extends to a series of transactions, it may be revoked by the surety as to future transactions by giving notice to the creditor. The Act contemplates series of distinct and separate transactions to constitute a continuing guarantee which can be revoked by notice.

ii) **Death of surety**: In the absence of a contract to the contrary, a continuing guarantee is revoked by the death of the surety as to the future transactions. The estate of deceased surety is, however, liable for those transactions which had already taken place during the lifetime of the deceased. Surety's estate will not be liable for the transactions taking place after the death of surety even if the creditor had no knowledge of surety's death.

iii) **Novation**: A contract of guarantee is discharged by novation when a fresh contract being entered into, either between the same parties or between other parties, the consideration being the mutual discharge of the old contract. The original contract of guarantee comes to an end and so the surety stands discharged with regard to the old contract.

9.11.2 By Conduct of the Creditor

i) **Variance in terms of the contract**: A surety is discharged by such conduct of the creditor which has the effect of materially altering the terms of the contract of guarantee. For example, C contracts to lend B Rs. 2,000 on 1st January. A guarantees repayment, C pays the amount to B on 30th August, A is discharged from the liability as the contract has been varied. A surety is liable only for what he has positively undertaken in the guarantee, any alteration made without the surety's consent, in the terms of contract between the principal debtor and the creditor, will discharge the surety as to transactions subsequent to the variation (Section 133). For 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 suretyship due to the variance made in the terms without his consent.

ii) **Release or discharge of the principal debtor**: A surety is discharged if the creditor makes a contract with the principal debtor by which the principal debtor is released, or by any act or omission of the creditor, which results in the discharge of the principal debtor (Section 134). For example, A supplies goods to B on the guarantee of C. Afterwards B becomes unable to pay and contracts with A to assign some property to A in consideration of his releasing him from his demands on the goods supplied. Here, B is released from his debt, and C is also discharged from his suretyship. Or, to take another example, where A contracts with B for a fixed price to build a house for B within a specified time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber, A is discharged from performing the contract and C is discharged from his suretyship.

But, where the principal debtor is discharged of his debt by operation of law, say, on insolvency, this will not operate as a discharge of the surety. Also, where there are co-sureties, a release by the creditor of one of them does not discharge other co-sureties nor does it frees the surety so released from his responsibility to other sureties.

iii) **Arrangement between principal debtor and creditor**: Where the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or promise to give him time to, or not to sue him, the surety will be discharged (Section 135).

However, when the contract to allow more time to the principal debtor is made between the creditor and a third party, and not with the principal debtor, the surety is not discharged (Section 136). For 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.

Similarly, mere forbearance by the creditor to sue the principal debtor or to enforce any other remedy against him, in the absence of any provision in the guarantee to the contrary, does not discharge the surety. For example, A owes Rs. 10,000 to K. The debt is guaranteed by M. The debt becomes payable but K does not sue A for six months after the debt has become payable. This will not discharge M.

iv) **By creditor's act or omission impairing surety's eventual remedy**: If the creditor does any act which is against 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 the surety himself against the principal debtor is thereby impaired, the surety is discharged (Section 139). For example, B, a shipbuilder, contract to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages (the last instalment not to be paid before the completion of the ship). A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays the last instalment to B. A is discharged by this payment. Take another example, A puts M as 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 makes up the cash. B omits to see as promised, and M embezzles. A is not liable to B on his guarantee.

v) **Loss of security**: If the creditor parts with or loses any security given to him at the time of the guarantee, without the consent of the surety, the surety is discharged from liability to the extent of the value of security (Section 141). For example, A, as surety for B, makes a bond jointly with B to C to secure a loan from C to B. Later on, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

9.11.3 By Invalidation of the Contract

A contract of guarantee, like any other contract, may be avoided if it becomes void or voidable at the option of the surety. A surety may be discharged from liability in the following cases:

i) **Guarantee obtained by misrepresentation**: When a misrepresentation is made by the creditor or with his knowledge or consent, relating to a material fact in the contract of guarantee, the contract is invalid (Section 142).

ii) **Guarantee obtained by concealment**: When a guarantee is obtained by the creditor by means of keeping silence regarding some material part of circumstances relating to the contracts, the contract is invalid. (Section 143).

iii) **Failure of co-surety to join a surety**: When a contract of guarantee provides that a creditor shall not act on it until another person has joined in it as a co-surety, the guarantee is not valid if that other person does not join.

Check Your Progress C

1. What is subrogation?

   ....

   ....

   ....

2. What is meant by novation?

   ....

   ....

   ....

3. State whether the following statements are True or False

   i) The implied promise on the part of debtor to indemnify the surety enables the latter to recover from the principal debtor not only the sum he has rightfully paid under the guarantee but also sums he has paid wrongfully. (   )

   ii) The creditor may at his will release any of the co-sureties from his liability. (   )

   iii) Release of one co-surety automatically discharges the other co-sureties. (   )

   iv) Any alteration made without the surety's consent in the terms of contract between the principal debtor and the creditor, will discharge the surety as to transactions subsequent to the variation. (   )

   v) Omission of the creditor to sue the debtor within the period of limitation discharges a surety. (   )

4. Attempt the following cases, giving reasons for your answer:

   i) A bought B a motor car under a hire-purchase agreement by which he was to pay Rs. 10,000 per month. C guarantees these payments. A defaulted in the payment of his instalments, and it was agreed between A and B that A should give a cheque for Rs. 2,000 and

pay the rest of arrears at the end of the month. State whether C is discharged.

ii) X guaranteed the honesty of a servant in C's firm. The servant was guilty of dishonesty in the course of his service, but C continued to employ him and did not inform X of what had occurred. The servant committed further acts of dishonesty. C sought the court for the recovery of loss from X. Is X liable?

iii) B appointed X as his agent to collect his rents and required him to execute a fidelity bond in which C was surety. Sometimes after the execution of bond, C died and X committed various acts of dishonesty. Is C's estate liable for the loss caused to B?

iv) A gives guarantee to C for goods to be supplied by C to B. C supplies the goods to B in due course. Afterwards, becomes financially embarrassed and contracts with all his creditors to assign to them all his property in consideration of them releasing him from their demands. The sale proceeds of the property are just sufficient to pay 75 paise in the rupee. C sues A for the balance, Decide.

v) X guarantees a debt due by Y to Z, the creditor, on 1st December 2016. Two years are over after the due date and Y has not paid debt and X does not take any action against the debtor Y. Is X discharged from his liability?

vi) A, B and C stand surety for D's duly accounting of cash to E. They stand surety for different amounts: A for Rs. 10,000. B for Rs. 20,000 and C for Rs. 40,000. D makes a default of Rs. 30,000. Discuss the respective liabilities of A, B and C.

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9.12 LET US SUM UP

Contracts of indemnity and guarantee are specific contracts for which the Indian Contract Act has laid down detailed rules.

Contract of indemnity is defined as a contract by which one party promises to save the other party from loss caused to him by the conduct of promisor himself or any other person. Such contract can be express or implied. The person who promises to indemnify is called indemnifier and the person to whom the promise is made is called Indemnity-holder.

The indemnity-holder, when sued, is entitled to recover from the promisor (indemnifier): (i) all damages which he may be compelled to pay (ii) all costs of suit which he may have to pay, and (iii) all sums which he may have paid under the terms of the compromise of any such suit. He can recover these sums as soon as his liability has become certain. He need not pay the amounts first and then recover from the indemnifier.

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 person who gives the guarantee is called the 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 can be specific or continuing. Specific guarantee relates to a single transaction while continuing guarantee extends to a series of transactions. A continuing guarantee can be revoked: (i) by notice to the creditor, (ii) by death of the surety and (iii) by variance in the terms of the contract between the principal debtor and the creditor.

The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. His rights can be divided into three heads: (i) rights against the principal debtor, (ii) rights against the creditor, and (iii) rights against the co-sureties. He has the rights of subrogation and indemnity against principal debtor; right of recovering security and right of set off against the creditor; and right of contribution against the co-sureties.

The surety is discharged from liability: (i) by notice in case of continuing guarantee only, (ii) by surety's death (in case of continuing guarantee only), (iii) by novation, (iv) by variance in terms of the contract, (v) by release or discharge of the principal debtor, (vi) by arrangement between the creditor and the principal surety, eventual remedy, (vii) by loss of security by the creditor, and (ix) by invalidation of the contract of guarantee.

9.13 KEY WORDS

Indemnity: A promise to save the other party from loss caused to him by the conduct of the promisor himself or by the conduct of any person.

Indemnifier: The person who promises to indemnify.

Indemnified/Indemnity-holder: The person for whom the promise to indemnify is given.

Guarantee: A contract to perform the promise, or discharge the liability, of a third person in case of his default.

Surety: The person who gives the guarantee.

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

Novation: Fresh contract being entered into either between the same parties of between other parties, as a consequence of which the original contract of suretyship becomes discharged.

9.14 ANSWERS TO CHECK YOUR PROGRESS

A) 2. Yes, 3) No, 4) Yes,
5. No, because the object of the agreement is unlawful.

B) 3. i) False, ii) False, iii) True, iv) False, v) False.

4. i) no ii) consideration iii) invalid iv) Principal debtor

5. i) Yes, See Section 127 ii) No. The agreement is void.

iii) 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 – Section 128.

C) 3. i) False, ii) True, iii) False, iv) True v) False

5) i) C is discharged from the whole contract, because B had agreed to give time to A, and the contract was one contract and not a series of monthly contracts.

ii) X is not liable and C cannot recover his loss from X.

iii) This is a type of continuing guarantee. It is revoked by the death of surety as to future defalcations. In this case C's state is liable for the loss up to the date of death.

iv) It is a compromise made without consulting the surety and hence, the surety is discharged.

v) A mere forbearance to sue does not discharge even if the debt becomes time-barred.

vi) A, B and C are liable to pay Rs. 10,000 each (Section 14).

9.15 TERMINAL QUESTIONS

1) Bring out the difference between a contract of indemnity and a contract of guarantee.

2) "Between a-sureties there is equality of the burden and the benefit". Elucidate.

3) Discuss clearly the nature of surety's liability. When is he discharged from his obligation?

4) Do you agree with the statement that 'The surety is a favoured debtor'? Give reasons for your answer.

5) State the rights of a surety against i) the principal debtor, ii) the creditor, and iii) co-sureties.

6) Narrate the essential features of a valid guarantee.

7) What do you understand by the right of subrogation . Explain with examples.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 10 BAILMENT AND PLEDGE

Structure

10.0 Objectives

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10.5 Duties of Bailee

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10.22 Terminal Questions

10.0 OBJECTIVES

After studying this unit, you should be able to:

- define bailment and distinguish it from other types of contracts;
- describe various kinds of bailments;

- explain rights and duties of bailor and bailee;
- describe the rights and duties of finder of goods;
- define pledge;
- explain rights and duties of pawnor and pawnee; and
- distinguish pledge from other types of contracts.

10.1 INTRODUCTION

Bailment and Pledge are also special class of contracts under Indian Contract Act 1872. The contract Act does not deal with all types of bailment. There are various other Acts e.g., The Railways Act 1890, Carriers Act 1865 etc. which deal with speical types of bailments.

In law we use the term bailment in its technical sense which means change of possession of goods from one person to another. Pledge, on the other hand is a kind of bailment for some special purpose such as where the goods are transferred from one person to another as security for payment of debt or performance of a promise. Pledge is different from bailment. In this unit you will learn the meaning of bailment, its kinds, rights and duties of both bailor and bailee. You will also learn the meaning of pledge, its difference with bailment, and rights and duties of pawnor and pawnee.

10.2 MEANING OF BAILMENT

Section 148 of the Indian Contract Act reads: *A bailment is the delivery of goods by one person to another 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 the person delivering them.* The person delivering the goods is called the "bailor". The person to whom they are delivered is called the "bailee". For example, you deliver some gold to a jeweller B to make bangles for your sister. In this case you are bailor and B is bailee and by delivering gold to B, a relationship of bailment is created between you and the jeweller. Take another example, if you give a piece of cloth to a tailor for stiching it as a shirt. There is a contract of bailment between you (Bailor) and tailor (Bailee).

Essentials of Valid Bailment

If you analyse the definition of bailment you will find that for creating a relationship of bailment the following features must be present:

i) Agreement

ii) Delivery of goods

iii) Purpose

iv) Return of the specific goods.

i) **Agreement**: For creating a bailment the first essential requirement is the existence of an agreement between the bailor and the bailee. As you have read just now bailor is the person who bails the goods and bailee is the person to whom the goods are bailed. The agreement between the bailor

and bailee, may be either express or implied. For example, between a finder of goods and the ture onwer, it is implied agreement.

ii) **Delivery of goods**: For bailment, it is necessary that the goods should be delivered to the bailee. It is the essence of the contract of bailment. It follows that bailment can be of movable goods only. It is further necessary that the possession of the goods should be voluntarily transferred and is in accordance with the contract. For example, A, a thief enters a house and by showing the revolver, orders the owner of the house to surrender all ornaments in the house to him. The owner of the house surrenders the ornaments. In this case although, the possession of goods has been transferred but it does not create bailment because the delivery of goods is not voluntary.

    Delivery of goods may be actual or constructive. Actual delivery means actual physical transfer of goods from one person to another. For example, when a person gives his scooter for repair to workshop, it is actual delivery. When physical possession of goods is not actually given but some such act is done which has the effect of putting the goods in the possession of bailee, or putting the goods in the possession of any other person authorised by the bailee to hold them on his behalf, it amounts to constructive delivery. Sometimes the other person may already be in possession of the goods of the bailor, and subsequently a contract of bailment is entered into, whereby the other person promises to keep the goods as bailee. This also amounts to constructive delivery of the goods. A railway receipt is a document of title to goods, a transfer of the railway receipt effects a constructive delivery of the goods.

iii) **Purpose**: In a bailment, the goods are delivered for some purpose. The purpose for which the goods are delivered is usually in the contemplation of both the bailor and the bailee.

iv) **Return of Specific goods**: It is important that the goods which form the subject matter of the bailment should be returned to the bailor or disposed off according to the directions of bailor, after the accomplishment of purpose or after the expiry of period of bailment.

Where goods are transferred by the owner to another, in consideration of price, it is a sale. Similarly, where the goods are not to be delivered back in specie but their price is paid, it is not a bailment. Again, where money is deposited by a customer with a bank in a current, savings or fixed deposit account, and, therefore, there is no obligation to return the identical money but an equivalent of it, it is no bailment. But what is thus created is a relationship of creditor and debtor. But, if valuables or even coins or notes in a box are deposited for safe custody there is a contract of bailment, for these are to be returned as they are, and not their monetary value.

Other common examples of a contract of bailment are where a watch is given for repairs, or diamonds are given for being set in a gold ring. In both these cases, the same watch or the same diamonds, should be returned after the purpose for which they were given, has been fulfilled. A pledge of a jewel on the security of which money is borrowed, gold jewels delivered to a bank for safe custody, goods delivered to a railway company for being carried and delivered to the consignee, are all examples of bailment

10.3 KINDS OF BAILMENT

Bailment may be classified on two bases, i.e., reward and benefit.

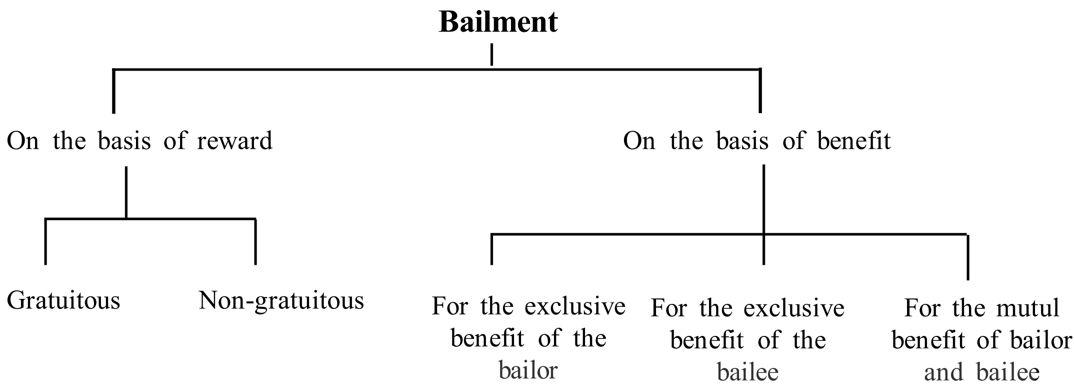

Fig. 10.1

On the Basis of Reward

Bailment can be classified as **gratuitous and non-gratuitous bailmen**t on the basis of whether the parties are getting or not getting some value out of the contract of bailment. When there is no consideration involved in the contract of bailment it is called a gratuitous bailment. For example, when you lend your cycle to your friend so that he can have a ride or when you borrow his books to read, it is a case of gratuitous bailment because no exchange of money or any other consideration is involved. Neither you nor your friend would be entitled to any remuneration here.

A contract of bailment which involves some consideration passing between bailor and bailee, is called a non-gratuitous bailment. For example, if your friend hired a cycle from a cycle shop or you borrowed a book from a bookshop on hire, this would be a case of non-gratuitous bailment.

On the Basis of Benefit

On the basis of the benefits accruing to the parties, the contract of bailment may be divided into the following types:

i) **Bailment for the exclusive benefit of the bailor**: This is the case where a contract of bailment is executed only for the benefit of the bailor, and the bailee does not derive any benefit from it. For example, if you are going out of station and leave your valuable goods with your neighbour for safety, it is you as bailor, who alone is being benefited by this contract.

ii) **Bailment for the exclusive benefit of the bailee**: This is the case where the contract of bailment is executed only for the benefit of the bailee and the bailor does not derive any benefit from the contract. For example, if you lend your books to a friend, without charge, So that he can study for his exams, it is your friend as the bailee, who alone is going to be benefited by this contract.

iii) **Bailment for the mutual benefit of bailor and bailee**: In this case both the bailor and the bailee derive some benefit from the contract of bailment.

For example, if you give your shirt to be stitched by the tailor, both of you are going to be benefited by this contract, while you get a stitched shirt, the tailor gets the stitching charges.

Check Your Progress A

1. Define Bailment

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....

2. Write any two essentials of bailment.

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....

3. To create a valid bailment is it essential that the goods must be transferred physically from the bailor to the bailee?

....

....

....

4. Which of the following statements are True or False.

   i) Bailment and Pledge are examples of specific contracts. ( )

   ii) No bailment can be created without an agreement. ( )

   iii) In bailment, the purpose for which the goods are delivered is usually in the contemplation of both the bailor and bailee. ( )

   iv) When there is no consideration involved in the contract of bailment, it is called s non-gratuitous bailment. ( )

   v) In bailment the person delivering the goods is called the bailee. ( )

10.4 DUTIES OF BAILOR

A bailor has the following duties.

1) **Duty to disclose defects**: The law of bailment imposes a duty on bailor to disclose the defects in the goods bailed. Bailor is under an obligation to inform those defects in the goods which would interfere with the use of the goods for which the goods being bailed or would expose the bailee to some risk. Bailment of goods may be either gratuitous (in which neither

bailor nor the bailee gets any reward) or non-gratuitous (bailment for reward). In case of gratuitous bailment, the law imposes a duty on the bailor to reveal all the defects known to him, which would interfere with the use of goods bailed. If the bailor does not disclose the defects and the bailee in consequence suffers some loss, the bailor would be liable to compensate the bailee for the losses so suffered. For example, A the owner of a scooter allows B, his friend, to take his scooter for a joy ride. A knows that the brakes of the scooter were not working well. A does not discloses this fact to B. Consequently, B meets with an accident. A is liable to compensate B for damages.

In case of non-gratuitous bailment, i.e., bailment for reward, the bailor has a duty to keep the goods in a fit condition. The goods should be fit to be used, for the purpose, they are meant. In such a case the bailor is responsible for all defects in the goods whether he knows the defects or not is immaterial, and if the bailee suffers any loss, the bailee has to bear it. For example, A hires a tractor from B, for ploughing his field. The shaft of the tractor is broken but B is not aware of the defect. While A was ploughing his field because of the defect, the tractor overturns and A is injured. B is liable for A's losses.

You should note that in case of gratuitous bailment the bailor is responsible only for those defects which he is aware of and did not disclose to the bailee. Duty to reveal is all the more important, where the goods bailed are of dangerous nature, otherwise the bailor would be liable for the resulting consequences. For example, A delivers to B, certain chemicals, to be carried to Bombay. These chemicals have a tendency to burst, if not kept below a certain temperature. A does not tell B to take this precaution. While carrying the chemicals, the chemicals burst and injure B. A is liable for all the damages.

2) **Duty to bear expenses**: The general rule in those bailments where the bailee is not to receive any remuneration is that the bailor should bear the usual expenses in keeping the goods or in carrying the goods or to have work done upon them by the bailee for the bailor. The bailor must repay to the bailee all the necessary expenses which the bailee has already incurred for the purpose of bailment. For example if A, a farmer gives some gold to his friend B. who is a goldsmith, to make a gold ring. B is not to receive any remuneration for the job. But A has a duty to repay to B any expenses incurred by him in making the ring.

   In cases of non-gratuitous bailments (where the bailee is to receive remuneration) bailor has a duty to bear extraordinary expenses, borne by the bailee for the purposes of bailment. However, the bailor is not to bear ordinary or usual expenses. For example, if a horse is lent for a journey, the expenses for feeding the horse would be payable by the bailee. But, if the horse becomes sick and expenses have to be incurred, or if the horse is stolen and expenses are incurred for recovery, the bailor should pay those expenses.

3) **Duty to indemnify the bailee**: It is the duty of the bailor to indemnify the bailee, for any loss which the bailee may suffer because of the bailor's title being defective. The reason for this is that the bailor was not entitled to make the bailment or to receive back the goods bailed or to give

directions regarding the goods bailed. For example, A asks his friend B to give him cycle for one hour. B instead of his own cycle gives C's cycle to A. While A was riding, the true owner of the cycle catches A and surrenders him to police custody. A is entitled to recover from B all costs, which A had to pay in getting out of this situation.

4) **Duty to bear risks**: It is the duty of bailor to bear the risk of loss, deterioration and destruction, of the things bailed, provided that the bailee has taken reasonable care to protect the goods from loss etc.

5) **Duty to receive back the goods**: It is the duty of the bailor that when the bailee, in accordance with the terms of bailment, returns the goods to him the bailor should receive them. If the bailor, without any reasonable reason refuses to take the goods back, when they are offered at a proper time and at a proper place, the bailee can claim compensation from the bailor for all necessary and incidental expenses, which the bailee undertakes to keep and protect the goods.

10.5 DUTIES OF BAILEE

A bailee has the following duties:

1) **Duty to take reasonable care of the goods bailed**: Section 151 of the Indian Contract Act lays down the degree of care, which a bailee should take, in respect of goods bailed to him. 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. The standard of care is same whether the bailment is gratuitous or for reward. So a bailee is liable when the goods suffer loss due to the negligence on the part of bailee.

   However, under Section 152 of the Act, the standard of care of ordinary prudent man can be increased by entering into a contract, between the bailor and the bailee. In that situation the bailee, in order to save himself from any liability, would be bound to take as much care, as provided by the terms of contract. In the absence of any such contract, if the bailee has taken care as an ordinary prudent man of the goods bailed, he is not responsible for the loss, destruction or deterioration of the goods bailed. To take an example, if a diamond ring is kept by its owner A for safe custody with another person B and B is not to receive any reward for it, the bailee should keep it locked in an iron safe, or some other safe place but not keep it in his lumber room, simply because the bailment is gratuitous. Similarly, if a cow is delivered for safe custody it is sufficient if it is kept in the backyard properly enclosed and even if it is for reward, no one would expect it to be kept in the drawing room. If the goods get stolen, lost or otherwise destroyed, even after the bailee has taken reasonably good care, the bailee would not be liable for this loss. The bailor, would have to bear this loss.

2) **Not to make any unauthorised use of goods**: The bailee is under a duty to use the bailed goods in accordance with the terms of bailment. If bailee does any act with regard to the goods bailed, which is not in accordance with the terms of bailment, the contract is voidable at the option of the bailor. Besides it, the bailee is liable to compensate the bailor for

any damage caused to the goods by an inconsistent use of the goods bailed. If he makes unauthorised use of goods, bailee would not be saved from his liability even if he has taken reasonable care of the ordinary prudent man. For example, A lends his car to B to be taken to Delhi from Hyderabad. The car was to be driven by B himself. B takes along with him a friend C, who has been driving his car for the last 10 years. B instead of going to Delhi, goes to Kolkata. The contract becomes voidable at the option of the bailor. On way to Kolkata, B allows C to drive the car. In spite of the fact that C, in accordance with the directions of B, drives the car at a very slow speed, an accident takes place and the car is damaged. A is entitled to be compensated for the loss.

3) **Duty not to mix bailor's goods with his own goods**: Next duty of the bailee is to keep the goods of the bailor separate from his own. Sections 155 to 157 of the Act lays down this duty in the following ways:

   i) If the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced (Section 155).

   ii) If the bailee, without the consent of the bailor, mixes the goods of the bailor with his goods, and the goods can be a separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expense of separation or division, and any damages arising from the mixture (Section 156). For example, A bails 100 bales of cotton marked with a particular mark to B. B, without A's consent, mixes these 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.

   iii) If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods (Section 157).

   A bails a barrel of cape flour worth Rs. 50 to B . B without A's consent mixes the flour with country flour of his own, worth Rs. 20 a barrel. B must compensate A for the loss of his flour.

Where a bailee mixed his own goods with those of the bailor and when ordered to return the goods of the bailor he offered to return the goods without sorting them out. It was held that the bailor was entitled to refuse to take delivery in toto and claim compensation for loss or damage.

4) **Duty not to set up adverse title**: The bailee is duty bound not to do any act which is inconsistent with the title of the bailor. He should not set up his own title or the title of a third party on the goods bailed to him.

5) **Duty to return the goods**: It is the duty of the bailee to return or to deliver the goods according to the directions of bailor, without demand,

on the expiry of the time fixed or when the purpose is accomplished. If he does not return or deliver as directed by the bailor, or tender the goods at the proper time, he becomes liable to the bailor for any loss, destruction or deterioration of the goods from that time. **He is liable even without his negligence.** For example, a book-binder kept books beyond the time allowed to him for binding, and they were lost in an accidental fire, the book binder is liable. If however, the bailment is gratuitous, then the bailee will have to return the goods loaned, at any time on demand by the bailor, even though the goods were lent for a specified time or purpose. But if on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan the lender must, if he compels the return, indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived.

6) **Duty to return accretions to the goods**: In the absence of any contract to the contrary, the bailee must deliver to the bailor, or according to his directions, any increase or profit which have accrued from the goods bailed. For example, A leaves a cow in the custody of B to be taken care of. The cow gives birth of a calf. B is bound to deliver the calf as well as the cow to A.

10.6 RIGHTS OF BAILOR

A bailor has the following rights.

1) **Enforcement of bailee's duties**: You have just now read the duties of the bailee. Duties of the bailee are the rights of the bailor. For example, when the bailee returns the goods bailed, he should also return all natural accretions to the goads. This is a duty of the bailee and it is the right of the bailor to receive all natural accretions in the goods baited, when the goods are returned to him.

2) **Right to claim damages**: It is an inherent right of the bailor to claim damages for any loss that might have been caused to the goods bailed, due to the bailee's negligence (Section 151).

3) **Right to avoid the contract**: If the bailee does any act, in respect of the goods bailed, which is inconsistent with the terms of bailment, the bailor has a right to avoid the contract. For example, A lends his car to B for B's personal use. B starts using the car as a taxi. A can avoid the contract (Section 153).

4) **Right to claim compensation**: If any damage is caused to the goods bailed because of the unauthorised use of the goods, the bailor has a right to claim compensation from the bailee. In the same way the bailor has a right to claim compensation, if some loss is caused to the goods bailed, due to unauthorised mixing by bailee, of bailee's own goods with the goods of the bailor (Sections 154, 155 and 156).

5) **Right to demand return of goods**: It is a right of the bailor to compel the bailee, to return the goods bailed, when the time of bailment has expired or when that purpose for which the goods were bailed has been accomplished.

In the case of a gratuitous bailment, even if the goods have been bailed for a fixed time or for a fixed purpose, the bailor has a right to compel the bailee to return them, before the agreed time.

10.7 RIGHTS OF BAILEE

The duties of bailor are the rights of bailee and bailee can enforce his rights against the bailor by suing him in case of a default. The rights of bailee are as follows.

1) **Right to claim damages**: If the bailor has bailed the goods, without disclosing the defects in the goods, and the bailee has suffered some loss, the bailee has a right to sue the bailor for damages. A hires a carriage of B. The carriage is unsafe, though B is not aware of it, and A is injured. B is responsible to A for the injury (Section 150).

2) **Right to claim reimbursement:** In case of non-gratuitous bailment the bailee has a right to recover from the bailor, all necessary expenses, which the bailee had incurred for achieving the purpose of bailment. In case of a gratuitous bailment, bailee has a right to recover from the bailor, all extraordinary expenses, borne by the bailee for the purposes of bailment (Section 158).

3) **Right to recover losses**: It is a right of bailee to recover from the bailor, all losses suffered by him by reason of the fact that the bailor was not entitled to make the bailment of the goods or to receive back the goods, or to give directions regarding them (Section 164).

4) **Right to deliver goods to any one of the joint bailors**: If the goods are owned and bailed by more than one person, the bailee has a right, in the absence of a contrary contract, to deliver back the goods to any one of the joint owners, or may deliver the goods back according to the directions of one joint owner, without the consent of all. (Section 165).

5) **Right to deliver the goods to bailor even if his title is defective**: If the title of bailor is defective and the bailee, in good faith returns the goods to the bailor or according to the directions of bailor, the bailee is not liable to the true owner in respect of such delivery (Section 166).

6) **Right of lien**: When the bailee, in accordance with the purpose of agreement has rendered any service involving the exercise of labour or skill, to the goods bailed, and his lawful payments are not made by the bailor, the bailee has a right to retain unless there is a contract to the contrary, the goods bailed, until he received his remuneration for the services rendered by him. This right to retain goods is known as **bailee's lien** (Section 170).

The bailee has a right of lien in respect of charges due to him for work of labour done in respect of goods bailed. As you have already read, the right of lien is a right to detain goods belonging to another, by a person in possession, until the sum claimed or other demand of the person in possession is satisfied. The Indian Contract Act has dealt with the following kinds of lien: (i) lien of a finder of goods (Section 168); (ii) particular lien of bailee (Section 170); (iii) general lien of bankers, factors, wharfingers, attorneys and policy brokers

(Section 171); (iv) lien of pawnees (Sections 173, 174); and (v) lien of agents (Section 221). The lien of a pawnees is dealt separately in this unit. The lien of agents is discussed in the separate unit, "Contract of Agency".

Possession of goods is necessary to claim the right of lien. The possession must be rightful, not for a particular purpose and lastly it should be continuous. For example, A, a trader took on lease, B's warehouse for 5 years. It was also agreed between A and B that A can at any time deposit or take out his goods from the warehouse. After six months A stopped paying the lease rent. B detained A's goods and claimed lien. B cannot claim lien because it was agreed that A can take out his goods whenever he wanted.

A lien may be either a particular lien or a general lien.

Particular Lien: A lien which can be exercised only on goods in respect of which some payment is due is called particular lien. Where the bailee has, in accordance with the purpose of the bailment, rendered any service involving the exercises 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 received due remuneration for the services he has rendered in respect of them (Section 170). For example, 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 service he has rendered. Again, 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.

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Conditions:

As a general rule a bailee is entitled only to particular lien, which means the right to retain only that particular property in respect of which the charge is due. The right is available subject to certain important conditions. (1) The foremost among them is that the bailee must have rendered some service involving the exercise of labour or skill or expenses incurred in respect of the goods bailed. (2) Further, a bailee's right of lien arises only where "labour and skill" have been used so as to confer an additional value on the article. So, a person who takes an animal for feeding has no lien, but a veterinary surgeon who has treated the animals has right of lien. (3) Further conditions are that the contract has been fully in accordance with the contract, and goods, as you already know, are still in possession of the bailee and there exists no contract for payment of price in future.

General Lien: The right of general lien, as provided for in Section 171, means the right to hold the goods bailed as security for a general balance of account. Whereas right of particular lien entitles a bailee to detain only that particular property in respect of which charges are due. Right of general lien entitles the bailee to detain any goods bailed to him for any amount due to him whether in respect of these goods or any other goods. The right of general lien is privilege and is specially conferred by Section 171 on certain kinds of bailees only. They are bankers, factors, wharfingers, attorneys of a high court, and policy brokers.

10.8 RIGHT OF BAILOR AND BAILEE AGAINST WRONGDOER

If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury. Section 180 of the Act enables a bailee to sue any person who has wrongfully deprived him of the use or possession of the goods bailed or has done them an injury. It says: *If a third person wrongfully deprives the bailee of the use of possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used is the like case if no bailment had been made; and either the bailor or the bailee may bring a suit against a third person for such deprivation or injury.*

Section 181 provides for apportionment of the relief obtained by the bailee and reads: *Whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and the bailee, be dealt with according to their respective interests.* For example, A, forcefully takes possession of a colour T.V. from B's repair shop. Now either the owner of the T.V. or B may sue A. If B files the suit, he shall hand over the amount received, after deducting his repair charges, to the owner of the T.V.

Check Your Progress B

1. Describe any three duties of a bailor.

   ....

   ....

   ....

   ....

2. Fill in the blanks:

   i) The law of bailment imposes a duty on the bailor to .... the defects in the goods bailed.

   ii) In case of a non-gratuitous bailment, the bailee has a duty to keep the goods in a .... condition.

   iii) The bailee is bound to take as much care of the goods bailed, as a man of ordinary .... would under similar circumstance, take of his own goods of the same bulk and value, as the goods bailed.

   iv) In the absence of any contrary contract, the bailee must deliver to the bailor any .... in the goods bailed.

   v) Possession of goods is necessary to claim the right ....

   vi) Bailor has a right to claim .... from the bailee for any loss caused to the goods bailed.

3. Describe any four rights of a bailee.

....

....

....

....

10.9 FINDER OF GOODS

A person who finds some goods, which do not belong to him, is called, finder of goods. It is his duty to find out the actual owner and surrender the goods to him. He has no right to sue the owner for compensation for trouble and expenses voluntarily incurred by him, in finding the owner and in preserving the goods found. But he has a right to retain the goods against the owner until he receives such compensation from the owner. If the owner has offered some specific award on the lost goods, the finder may sue the owner for the award and till then can exercise his right to lien over the goods.

As against every one except the true owner, the ownership of goods found in a public place, vests in the finder. Thus, a person who picks upon the floor of a shop, a packet of bank notes accidently dropped by a stranger, is entitled to the notes, as against the whole world except the true owner.

10.9.1 Rights of a Finder of Goods

Rights of a finder of goods are as follows:

1) **Right of lien**: A finder of goods has the right to keep the goods in his possession till he is paid his expenses. He can exercise the right of lien against the goods found. This right is available against the true owner until the finder of goods receives compensation for expenses and trouble incurred by him is finding out the true owner and in preserving the goods found. However, he has no right to sue the real owner for such compensation.

2) **Right to sue for reward**: If the true owner of goods has declared some award for the return of lost goods, the finder can sue the owner for such award. He will have the right of lien, over the goods till he receives the award.

3) **Right of sale**: A finder of goods has a right to sell the goods found by him under the following circumstances.

   i) where the owner cannot, with reasonable diligence, be found and if found, refuses to pay the lawful charges of finder of goods, or

   ii) the goods found are such as is commonly the subject of sale, or

   iii) the thing is in danger of perishing or of losing the greater part of their value, or

   iv) when the lawful charges of the finder for preservation and finding out the owner, amount to two-thirds of the value of the thing.

10.9.2 Duties of a Finder of Goods

Under Section 71 of the Contract Act, a finder of goods has same duties with regards the goods found, as that of a bailee. Hence,

1) The finder should take reasonable care of the goods found.

2) He should not put the goods for his personal use.

3) He should not mix the goods found with his own goods.

4) It is the duty of the finder of goods to find the real owner of the goods and then to entrust the goods to him. For example, if at a birthday party, a guest finds a gold ring and he tells the host and few other guests about it, he has performed his duty to find the owner. If he is not able to find the owner he can keep the ring as bailee. Refer to Block 2, Unit (8).

10.10 TERMINATION OF BAILMENT

A contract of bailment comes to an end under the following cases:

1) **On the expiry of fixed period:** If the goods are bailed for a fixed time, the bailment is terminated at the end of that period.

2) **On the fulfilment of the object:** If the goods are bailed for some specific purpose or purposes, the bailment is terminated on fulfilling the object.

3) **Inconsistent use of bailed:** If the bailee uses the goods in contravention of the terms of bailment, the bailor may terminate the bailment even before the term of bailment .

4) **Destruction of the subject matter:** A bailment is terminated if the subject matter of the bailment is destroyed or because of some change in the nature of goods bailed if the goods become incapable of being used for bailment.

5) **Termination of gratuitous bailment:** As you have already read, a gratuitous bailment can be terminated by the bailor at any time even though the bailment was for a fixed period or purpose. But in such a case, the loss to be suffered by the bailee from such premature termination should not exceed the benefit he had derived from the bailment. If the loss exceeds the benefit, the bailor shall indemnify the bailee.

6) **Death:** A gratuitous bailment is terminated by the death of either the bailor or the bailee.

Check Your Progress C

1. Fill in the blanks:

   i) A person who finds some goods belonging to some other person is called .... of good.

   ii) A finder of goods cannot recover the ....voluntarily incurred by him, in finding the owner.

   iii) If the owner of lost goods has declared some award for the return of lost goods, the finder can ....the owner for such award.

iv) A bailment is terminated, when because of some change in the ....:..... of goods bailed, the goods become incapable of being used for bailment.

v) A gratuitous bailment is terminated by the .... of either the bailor or the bailee.

2. Which of the following statements are True or False.

i) A finder of goods has a right to retain the goods until he is paid his expenses by the owner, ( )

ii) A finder of goods has a right to sell the goods found, if the lawful charges for preserving the goods amount to 2/3 of the value of the things. ( )

iii) If the goods are bailed for a fixed period, the bailment does not necessarily terminate at the end of that period. ( )

iv) A bailment is terminated if the subject matter of the bailment is destroyed. ( )

v) A gratuitous bailment cannot be terminated by the bailor before the expiry of the time for which the goods were bailed. ( )

10.11 MEANING OF PAWN OR PLEDGE

Pawn or Pledge is a special kind of bailment where a movable thing is bailed as security for the repayment of a debt or for the performance of a promise. For example, if you borrow rupees one hundred from B and keep your cycle with him as security for repayment, it is a contract of pledge. The person taking the loan is called the pledger or pawnor and the person with whom goods are pledged is called the pawnee. Ownership of the pledged goods does not pass to the pledgee. The general property remains with the pledger but a "special property" in it passes to the pledgee. The special property is a right to the possession of the articles along with the power of sale on default. Delivery of the goods pawned is a necessary element in the making of a pawn. The property pledged should be delivered to the pawnee. Thus, where the producer of a film borrowed a sum of money from a financier-distributor and agreed to deliver the final prints of the film when ready, the agreement was held not to amount to a pledge, there being no actual transfer of possession. Delivery of possession may be actual or constructive. Delivery of the key of the godown where the goods are stored is an example of constructive delivery. Where the goods are in the possession of a third person, who, on the directions of the pledger, consents to hold them on the pledgee's behalf, that is enough delivery. A railway receipt is a document of title of the goods and a pledge of the receipt operates as a pledge of the goods.

10.12 WHO MAY PLEDGE

Any of the following persons may make a valid pledge:

i) The owner, or his authorised agent, or

ii) One of the several co-owners, who is in the sole possession of goods, with the consent of other owners, or

iii) A mercantile agent, who is in possession of the goods with the consent of real owner, or

iv) A person in possession under a voidable contract, before the contract is rescinded, or

v) A seller, who is in possession of goods after sale or a buyer who has obtained possession of the goods before sale, or

vi) A person who has a limited interest in the property. In such a case the pawn is valid only to the extent of such interest.

10.13 PLEDGE AND BAILMENT

Pawn and bailment have many similarities. In both the cases only the movable goods are delivered with the condition that the goods shall be delivered back after the purpose of contract is over or after the expiry of stipulated time. Both pawn and bailment contracts are created by agreement between the parties.

However, pawn differs from bailment in the sense that pawn is bailment of goods for a specific purpose i.e., repayment of a debt or performance of a duty. Whereas, the bailment is for a purpose of any kind. Secondly, the pawnee cannot use the goods pawned, but in bailment the bailee use the goads bailed if the terms of bailment so provide. Thirdly, pawnee has a right to sell the goods, pledged with him after giving notice to pawnor, in case of default by the pawnor to repay the debt, whereas bailee may either retain the goods or sue bailor for his dues.

10.14 PLEDGE AND HYPOTHECATION

Both pledge and hypothecation are created by an agreement between the parties. In both, movable property is delivered as a security for repayment of loan or for the performance of a promise. The difference in hypothecation and pledge is that, that in hypothecation the debtor continues to enjoy the possession of goods. The debtor has a right to deal in the goods but only subject to the terms of contract. He has to send to the creditor, the details of property hypothecated. The creditor, in hypothecation, has a right to inspect the goods, at his convenience, whereas, in case of pledge, the pawnor loses the possession of the property as well as his rights to deal in the property pledged.

10.15 RIGHTS OF PAWNEE

As you already know pledge is an extension of bailment, therefore the pawnor and pawnee have almost the same rights and duties as those of the bailor and bailee. Their rights may be studied as follows:

1) **Right of retainer**: The pawnee has right to retain the pledged goods till his payments are made (Sections 173 and 174).

   He can retain the goods for the following payments:

   a) for the payment of the debt or performance of the promise,

b) interest on the debt, and

c) for all necessary expenses incurred by him in respect of the possession or for the preservation of the pledged goods. This right of the pawnee to retain the pledged goods till he is paid, is known as pawnee's right of particular lien, In the absence of a contrary contract, the pawnee cannot retain the goods pledged for any debt or promise other than the debt or promise for which the goods are pledged. However, in the absence of any thing to the contrary, such a contract shall be presumed when subsequent advances are made without any further security. If fresh security is provided for the fresh advance, this presumption will not apply.

2) **Right to Extraordinary Expenses (Sec. 175)**: The pawnee is entitled to receive from the pawnor extraordinary expenses incurred by him for the preservation of the goods pledged. This right does not entitle the pawnee to retain the goods for recovery of such expenses, however, he can sue the pawnor to pay such amount.

3) **Right to Sale (Sec. 176)**: Upon a default being made by the pawnor in the payment of the debt or performance of the promisee the pawnee gets two distinct rights. **Firstly,** the pawnee may bring a suit against the pawnor for the recovery of the due amount or for the performance of the promised duty and in addition to it he may retain the goods as a collateral security. **Secondly,** he may sell the goods pledged but only after giving reasonable notice of the intended sale, to the pawnor.

   If the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor. Further the pawnee cannot sell the goods to himself. If he does so the sale is void and the pawnor can take back the goods after paying the amount due.

4) **Right against the true owner of goods (Sec. 178 A)**: When the pawnor has acquired possession of pledged goods, under a voidable contract, but the contract has not been rescinded, at the time of pledge, the pawnee acquires a good title to the goods, even against the true owner, provided the pawnee had no notice of the pawnor's defect in title and he acts in good faith.

10.16 DUTIES OF PAWNEE

A pawnee has the following duties:

1) Duty to take reasonable care of the pledged goods.

2) Duty not to make unauthorised use of goods pledged.

3) Duty to return the goods when the debt has been repaid or the promise has been performed.

4) Duty not to mix his own goods with the goods pledged.

5) Duty not to do any act which is inconsistent with the terms of pledge.

6) Duty to deliver increase (if any), to the goods pledged.

10.17 RIGHTS AND DUTIES OF PAWNOR

10.17.1 Rights of Pawnor

If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before their actual sale; but he must, in that case, pay in addition, any expenses which have arisen from his default. Besides this, all the duties of a pawnee are the rights of a pawnor and so he has the right to get pawnee's duties duly enforced.

10.17.2 Duties of Pawnor

Following are the important duties of a pawnor:

1) It is the duty of pawnor to comply with the terms of pledge and repay the debt on the stipulated date or to perform the promise at the stipulated time.

2) It is the duty of pawnor to compensate the pawnee for any extraordinary expenses incurred by him for preserving the goods pawned.

10.18 PLEDGE BY NON-OWNERS

As you know that normally only the owner of goods can pledge them and that no one can pass a better title to the goods than what he himself has. But in order to facilitate mercantile transactions, the law has recognised certain exceptions. These exceptions are for bonafide pledges made by those persons who are not the actual owners of the goods, but in whose possession the goods have been left. You will now read those situations in which a non-owner too can make a valid pledge of the goods.

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 valid, provided that the pawnee acts in good faith and has, at the time of pledge, no notice of the fact that the agent has no authority to pledge (see 178). The necessary conditions of validity under the section are as follows:

   i) The person pledging the goods must be a mercantile agent,

   ii) Mercantile agent must be in possession either of the goods or the documents of title to goods,

   iii) Such possession must be with the consent of the owner. If possession has been obtained dishonestly or by a trick, a valid pledge cannot be effected,

   iv) Pledge must have been made by the mercantile agent, when acting in the ordinary course of business of a mercantile agent,

v) The pledgee must act in good faith; and

vi) The pledgee should have no notice of the pledger's defect of title. If the pledgee knows that the pledger has a defective title, the pledge will not be valid.

2) **Pledge by person in possession under voidable contract**: You have already read under earlier units that for the formation of a contract, the consent of parties should be free, i.e., the consent must not have been caused because of coercion, misrepresentation, fraud, undue influence or mistake or because of any of them. If the consent is caused because of any of them, such contract is voidable under Section 19 or 19 A of the Indian Contract Act, at the option of person, where consent was so obtained. Section 178 A of the Contract Act provides that where goods are pledged by a person who has obtained their possession under a voidable contract, the pledge is valid, provided that the contract has not been rescinded at the time of the pledge and the pledgee has acted in good faith and without notice of the pledger's defect of title.

3) **Pledge where pledger has only a limited interest**: Where the pawnor is not the absolute owner of the goods, but has only a limited interest and he pawns it, the pledge is valid to the extent of that interest. A finder of goods, a mortgagee or a person who has lien over the goods, may make a valid pledge of such goods, to the extent of his interest in the goods. For example, A finds a defective watch lying on the road. He picks it up, gets it repaired and pays Rs. 50 for the repairs. Later on he pledges the watch for Rs. 25. The true owner can recover the watch only on paying Rs. 50 to the pledgee.

4) **Pledge by a co-owner in possession**: Where the goods are owned by many persons and with the consent of other owners, the goods are left in the possession of one of the co-owners. Such a co-owner may make a valid pledge of the goods in his possession.

5) **Pledge by seller or buyer in possession**: A seller, in whose possession, the goods have been left after sale or a buyer who with the consent of the seller, obtains possession of the goods, before sale, can make a valid pledge, provided the pawnee acts in good faith and he has no knowledge of the defect in title of the pawnor. For example, A buys a cycle from B. But leaves the cycle with the seller. B then pledges the cycle with C, who does not know of sale to A, and acted in good faith. This is valid pledge.

Check Your Progress D

1. Define pledge.

....

....

....

2. Describe the right of retainer of a pawnee.

....

....

....

3. Which of the following statements are True or False:

   i) Pledge is a special kind of bailment. ( )

   ii) In pledge, the ownership of the goods pledged does not pass to the pledgee. ( )

   iii) A pledge can be created both of movable as well as of immovable property. ( )

   iv) In hypothecation the debtor loses the right to enjoy the goods. ( )

   v) It is the duty of a pawnor to compensate the pawnee for all extraordinary expenses incurred by him for preserving the goods pawned. ( )

   vi) A person who has obtained the possession of goods under a voidable contract cannot create a valid pledge of such goods. ( )

   vii) In a contract of pledge, even after the expiry of stipulated period, the pawnor can recover the goods pawned. ( )

10.19 LET US SUM UP

Bailment is delivery of goods by one person to another for some purpose upon the condition that the goods shall, when the purpose is accomplished be returned to the bailor or to any other person, according to the directions of bailor.

Bailment is classified into three categories i.e., for the exclusive benefit of bailor, for the exclusive benefit of the bailee and for mutual benefit of bailor and bailee. On the basis of reward a bailment may be classified as gratuitous or non-gratuitous bailment.

Lien means bailee's right to keep the goods in his possession till he is not paid his dues. A lien may be either a Particular lien or a General lien. A particular lien is available only against the goods in respect of which the bailee has rendered any service, labour or skill. While general lien signifies the bailee's right to retain, the goods bailed as well as any other property of the bailor, until the claims of bailee are satisfied.

Bailment comes to an end on the expiry of fixed period, on the fulfillment of the object of bailment, by doing some act which is inconsistent with the terms of bailment, with respect to the goods bailed and on the destruction of subject matter. A gratuitous bailment can be terminated even before the expiry of the term of bailment but then bailor is liable to compensate the bailee for the losses suffered by him.

Pledge on the other hand is a special kind of bailment, where a thing is delivered as security for the repayment of a debt or for the performance of a promise. By and large the pawnor and pawnee have the same rights and duties as that of bailor and bailee. However, if the pawnor defaults in the payment of the debt or performance of duty, the pawnee can sell the goods after giving a notice to the pawnor, and satisfy his debt. If the proceeds of such sale are insufficient, the pawnor it still liable to pay the balance. But if the proceeds of such sale

are greater than the amount due, the pawnee should refund the excess amount of the pawnor. Pawnee cannot sell the goods to himself.

Although the general rule is that no person can pass a better title to the goods than he himself has. It implies that only the true owner can pledge the goods. But under certain conditions pledge by a mercantile agent, pledge by person in possession of goods under a voidable contract, pledge by a person who has only a limited interest in the goods, pledge by a co-owner in possession, pledge by seller or buyer in possession, have also been recognised to create a valid pledge.

10.20 KEY WORDS

Bailment : A 'bailment' is the delivery of goods by some person to another 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 the person delivering them.

Bailor : The person delivering the goods is called the bailor.

Bailee : The person to whom the goods are delivered is called the bailee.

Factor : The word 'factor' in India, as in England, means an agent entrusted with possession of goods for the purpose of selling them for his principal.

General Lien : Bankers, factors, wharfingers, attorneys of a High Court, and Policy-brokers may, in the absence of a contract to the contrary, retain as a security for a general balance of account, any goods bailed to them; but no other persons have a right to retain, as a security for such balance, goods bailed to them, unless there is an express contract to that effect.

Mercantile agent : It means a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to buy goods, or to raise money on the security of goods.

Particular Lien : 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 services he has rendered in respect of them.

Pawn or Pledge : This is a kind of bailment where a thing is delivered as security for the repayment of a debt.

Wharfingers : Wharf means a place contiguous to water, used for the purpose of loading and unloading goods, and over which the goods pass in loading and unloading. Wharfinger is he that owns or keeps a wharf, or have the oversight or the management of it.

10.21 ANSWERS TO CHECK YOUR PROGRESS

A) 1. Refer to 10.3 of this unit.

2. No

3. i) True ii) True iii) True iv) False v) False

B) 1. Refer to 10.5 of this unit

2. i) disclose ii) fit iii) prudence iv) increase v) lien vi) damages

3. Refer to 10.8 of this unit.

C) 1. i) Finder ii) expenses iii) sue iv) nature v) death

2. i) True ii) False iii) False iv) True v) False

D) 1. Refer to 10.11 of this unit.

2. Refer to 10.16 of this unit.

3. i) True ii) True iii) False iv) False v) True vi) False. vii) True

10.22 TERMINAL QUESTIONS

1. Discuss the essentials of a contract of bailment and state the rights and duties of a bailee.
2. Examine the duties and rights of a bailor.
3. State the respective rights and responsibilities of pledger and pledgee.
4. What do you understand by lien? Describe particular lien and general lien of a bailee.
5. What is meant by pledge? Describe its essential features.
6. Narrate the circumstances under which a person other than the owner can make a valid pledge.
7. Explain the rights and duties of a finder of goods.
8. Write a note on pledge by mercantile agent.

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

UNIT 11 CONTRACT OF AGENCY

Structure

11.0 Objectives

11.1 Introduction

11.2 Contract of Agency

- 11.2.1 Who can Appoint an Agent?
- 11.2.2 Who may be an Agent?
- 11.2.3 Consideration for Agency
- 11.2.4 Constitution and Proof of Agency

11.3 Difference between Agent, Servant and Independent Contractor

11.4 Creation of Agency

11.5 Agency Relationship between Husband and Wife

11.6 Classification of Agents

11.7 Scope and Extent of Authority

11.8 Delegation of Authority by Agent

11.9 Sub-Agent and Substituted Agent

11.10 Agency by Ratification

11.11 Rights of an Agent

11.12 Duties of an Agent

11.13 Personal Liability of an Agent

11.14 Liability of Principal to Third Parties

11.15 Termination of Agency

11.16 Irrevocable Agency

11.17 Let Us Sum Up

11.18 Key Words

11.19 Answers to Check Your Progress

11.20 Terminal Questions

11.0 OBJECTIVES

After studying this unit, you should be able to.

- define an agent, differentiate between an agent, servant and an independent contractor and different classes of an agent;
- explain how agency is created and when an agent can delegate his authority;
- describe rights, duties and extent of authority of an agent;

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- describe the circumstances when an agent is personally liable and the extent of liability of the principal to third parties; and
- explain how an agency can be terminated.

11.1 INTRODUCTION

One of the most striking features of modern business organisation is the emergence, growth and importance of the middleman. In a modern business organisation, it is not always possible for a man to do everything by himself. Hence it is necessary to delegate some of his acts to be performed by another, and that person is called an 'agent' and the contract by which he is appointed is called contract of 'Agency'. The law of agency is based on the principle "What a person does by another, he does by himself".

In this unit you will learn the meaning of agency, creation of agency, authority, rights and duties of an agent, delegation of authority by an agent and difference between sub-agent and substituted agent. You will also learn about liabilities of an agent and principal to third parties and the methods of terminating agency.

11.2 CONTRACT OF AGENCY

According to Section 182 of the Contract Act An *'agent' is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the 'principal'*. Thus, it is clear from the definition, that an agent is a connecting link between his principal and third parties. Merely because one person gives advice to another in matters of business, the former does not become an agent of the latter. A company promoter's status is not that of an agent as he is acting for a company which is yet to come into existence. A person employed by another to invest money on his behalf and to represent him with debtors is an agent within the meaning of Section 132 (**Harbans Lal v. Producer Exchange Corporation**). Since an agent is employed mainly to bring about a contract between the principal and third parties, it is absolutely essential that both the principal and the third party must be persons capable of entering into a contract.

11.2.1 Who can Appoint an Agent?

Section 183 provides as follows: *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 an agent*. Thus, a minor, or a person of unsound mind cannot act as a principal. Though the section prohibits a minor from appointing an agent, does not perclude the guardian of a minor from appointing an agent to the minor (**Madanlal v. Bherulal**).

11.2.2 Who may be an Agent?

Section 184 of the Act provides answer to this question, which says: *As between the principal and the third persons any person may become an agent, but no person who is not of the age of majority and of sound mind can become an agent, so as to be responsible to his principal according to the provisions in that behalf herein contained*. From this section it becomes clear that "as between the principal and third persons, any person may become an agent".

Now the question arises, can a minor or a person of unsound mind also become an agent? The answer is yes. In view of the language used by this section even a minor or person of unsound mind is not debarred from being appointed as an agent. Thus, any person can be appointed as an agent. But as a rule of caution, they should not be appointed as agent because if the principal appoints them, he undertakes a great risk. Because whatever such incompetent person does shall be binding on the principal, but the principal shall not be able to proceed against the agent for his misconduct or negligence. For example, where A, a principal, entrusts to B, a minor a diamond ring worth Rs. 11,000 and instructs him not to sell the same for credit or for any amount less than Rs. 9,000. If B sells the same to C on credit for Rs. 5,000, this transaction will certainly be binding as between A and C but A will have no right to claim damages as against B for his misconduct, since B happens to be a minor, But, if B were an adult, he would be liable to A for damages sustained due to his misconduct.

11.2.3 Consideration for Agency

As you know, consideration is essential for the validity of every contract, and consideration, in the sense of detriment, is sufficient to support a contract. Section 185 expressly provides that *no consideration is necessary to create an agency*. The fact that the principal has agreed to be bound by the acts of the agent is a sufficient detriment to the principal. Therefore, it is not necessary that there should be a separate consideration. For example, when A employs B as his agent in as much as A's affairs are placed in B's hands, A suffers a detriment, and therefore, no further consideration in the shape of remuneration need be present. Thus, it means that there can be a gratuitous contract of agency and a gratuitous agent will be as much bound by his contract as a paid agent.

11.2.4 Constitution and Proof of Agency

The relationship of principal and agent may be created by (i) express appointment by the principal, or by a person duly authorised by the principal to make such appointment; (ii) by implication of law, from the conduct or situation of the parties or from the necessity of the case; or (iii) by subsequent ratification by the principal of the acts, done on his behalf. As to proof of agency, the actual status of the parties must be determined with reference to all the circumstances and not merely with reference to the words used. The crucial test of the status of an agent is that his acts bind the principal.

11.3 DIFFERENCE BETWEEN AGENT, SERVANT AND INDEPENDENT CONTRACTOR

There is too much of similarity between an agent and a servant as both are employed to act for and on behalf of principal. However, there is a lot of difference between the two. An agent has the authority to create contractual relationship between the principal and a third party, but a servant ordinarily, has no such authority. A servant usually serves only one master but an agent may work for several principals at the same time. A servant is generally paid salary or wages, whereas an agent may be paid on commission basis. Thus, we find that an agent is not a servant.

As for as the independent contractor is concerned he undertakes to produce a given result but in the actual execution he is not under the order or control of the person for whom he does it, and may use his own discretion. An agent work under the control and supervision of the principal. An agent represents his principal and can bird the principal by his acts but a contractor is independent and cannot bind his employer by his acts.

11.4 CREATION OF AGENCY

The relationship of principal and an agent may be created in any of the following ways:

1) express agreement,
2) implied agreement,
3) ratification, and
4) operation of law.

Look at the Figure 11.1 to have an overall view.

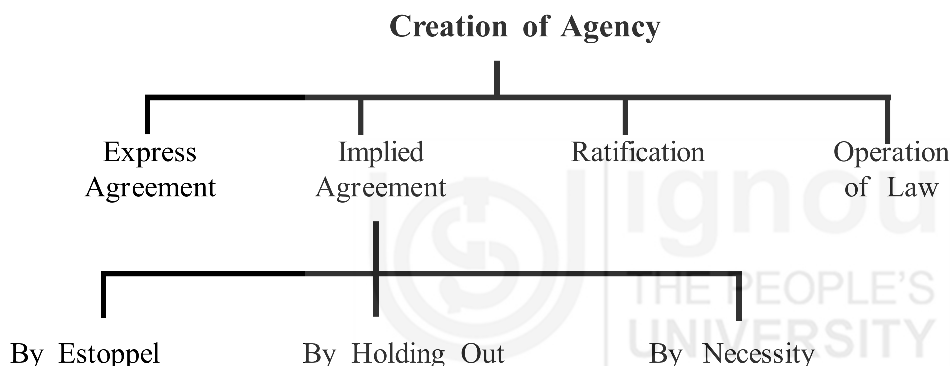

Fig. 11.1

Let us discuss them one by one in detail.

1) **Express Agreement**: You know that when an agent acts within the scope of his authority, his acts bind the principal as well as the third party. The agent derives this authority by the contract by which he is employed as an agent. This contract may be express or implied. Section 186 of the Act says "*the authority of an agent may be express or implied*". Section 187 further says, "*an authority is said to be express when it is given by words spoken or written. An authority is said to be implied when it is to be inferred from the circumstances of the case; and things spoken or written, or the ordinary course of dealing, may be accounted circumstances of the case*". For example, A is residing in Delhi and he has an agriculture farm at Mumbai. A appoints B, by a deed called the power of attorney, as a caretaker of his farm. In this way, the relationship of principal and agent has been created between A and B by an express agreement (power of attorney).

2) **Implied Agency**: From Section 187, you have seen that an agency may be implied when it is to be inferred from the circumstances of the case, things spoken or written, or ordinary course of dealing. For example, A

has a car, but he cannot drive it. He allows his neighbour B to drive it. B while driving the car with A meets with an accident and injures C. C can sue A for damages because B is his implied agent. Let us take another example. A and B are brothers. A lives in Delhi and B lives in Kanpur. B has a flat in Delhi. A with B's knowledge let out his flat. A used to realise the rent and remit the same to B who was accepting the same. Here A is the implied agent of B though he has not been expressly appointed, Implied Agency includes the following:

a) agency by estoppel,

b) agency by holding out and

c) agency by necessity,

a) **Agency by Estoppel**: First of all we should understand the meaning of the term 'estoppel'. The rule of estoppel says "where a person by his words or conduct has wilfully led another person to believe that certain set of circumstances or facts exists, and that other person has acted on that belief, then he is estopped or precluded from denying the truth of such statements, although such a state of thing did not exist in fact. Thus, when a person, by his conduct or statement, wilfully leads another person to believe that a certain person is his agent, then he is estopped or prevented from denying the truth of agency. For example, X tells Y in the presence and within the hearing of Z that he (X) is Z's agent. Z keeps quiet and does not contradict this statement. Later on Y enters into a contract with X, honestly believing that X is Z's agent. Z is bound by this contract, and in a suit between Z and Y, Z cannot be permitted to say that X was not his agent, even though X was not in actual fact his agent.

Section 237 of the Act deals with agency by estoppel. It says that *when an agent has, without authority, done an act or incurred an obligation to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by his words or conduct inducted such third persons to believe that such acts and obligations were within the scope of agent's authority*.

b) **Agency by Holding Out**: Agency by holding out is a type of agency by estoppel. Here, the alleged principal by 'his affirmative or positive conduct leads others to believe that person doing some act on his behalf is doing with his authority. For example, A allows his servant to purchase goods on credit from a nearby shop, and later on he pays for such goods. Later on, when the servant was not in A's employment, he buys goods on A's credit from the same shop. The shopkeeper can recover the price from A, because A had held out the servant as his agent on earlier occasions, so A will be bound for subsequent transactions entered into under similar circumstances.

c) **Agency by Necessity**: Sometimes, owing to the exigencies of circumstances, the law confers agency on some persons to act as an agent of .another person without waiting for the consent of that person. However, before an agency of necessity can be inferred, the following conditions have to be satisfied:

(i) There should be an actual and definite necessity for acting on behalf of the principal; (ii) within the available time it should be impossible to obtain the principal's instructions; (iii) the person acting as agent must have acted bonafide. In such situations, the principal is bound by the acts of the agent. For example, some milk was consigned from Mumbai to Delhi. The tanker carrying the milk met with an accident. The milk being perishable was sold by the transporter. The sale is binding upon the principal. In this case, the transporter became an agent by necessity.

The traditional examples of agency by necessity are those of the shipmaster who has powers to act during an emergency and the acceptor of a bill of exchange who is entitled to be reimbursed by the person whom he pays.

3) **Agency by Ratification**: By ratification, we mean, "*where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or disown such acts. If he ratifies them, the same effects will follow as if they have been performed by his authority*". Ratification may be express or implied in the conduct of the person on whose behalf the acts are done. For example, without A's authority, his brother B lends his money to C. Later on, C pays the interest on the landed money and A accepts the interest. A's conduct implies at ratification of the loan, and it may be presumed that his (A's) brother B's conduct in lending the money is as valid as if it were done in pursuance of his (A's) prior authority and this kind of agency is called 'agency by ratification'.

Effect of ratification: The effect of ratification is to make the agent's acts, done without prior authority as binding and valid upon the principal as if they had the prior sanction of the principal. In fact, ratification relates back to the date when the act was done by the agent and not to the date when the principal ratified the act.

4) **By operation of Law**: Another mode of creation of agency is by Operation of Law. In certain circumstances, the law treats one person as an agent of another. It can be better understood by the example that when a partnership is formed, every partner, by operation of law, automatically becomes the agent of other partners.

11.5 AGENCY RELATIONSHIP BETWEEN HUSBAND AND WIFE

Marriage does not of itself create the relation of agent and principal. A wife, in order to bind her husband by her dealings must receive authority from the husband either expressly or by implication from his conduct. The following principles may be noted in this connection:

i) If husband and wife are living together, and the wife is charged with the duty of looking after the household, presumption is raised that she has got the authority to pledge her husband's credit for necessaries **(Debenham v. Mellon**). But this presumption may be rebutted in the following cases:

a) where the wife is forbidden from purchasing anything on credit or from contracting debts;

b) where the goods purchased on credit are not necessaries;

c) where the wife is given sufficient money for purchasing necessaries, and forbidden from pledging his credit (**Move1 Bros. v. Westmoveland**), or where an adequate allowance is made to her, or she has means of her own, either in money or in earning capacity (**Biberfeld v. Bevens**);

d) where the trader has been expressly warned not to give credit to his wife.

ii) When the wife lives apart from the husband under justifiable circumstances, the husband would, in law, be liable to maintain her, and he would be bound to pay her bills for maintenance during that period. But if she is living separately without any valid reasons, then she cannot pledge her husband's credit even for necessaries.

11.6 CLASSIFICATION OF AGENTS

Agents are classified in several ways. They can be classified (a) on the basis of the extent of authority and (b) on the basis of nature of work.

On the basis of extent of authority

From the point of view of authority given to them, they can be divided into general agents and special agents. **General agents** have the authority to act in all matters concerning a trade or profession, or of a particular nature or to do some act in the ordinary course of his trade or profession. **Special agents** have authority only to act in a particular transaction, for example, when an agent is appointed to sell a car or sell a house. The authority of a special agent is limited to that particular act only and his authority comes to an end when the work is over. Thus, the persons dealing with such agent are under an obligation to correctly ascertain from the principal the extent of his authority. On the other hand, a general agent has the authority to do all legal acts for the purpose of carrying on that trade or business, on behalf of his principal. It should be noted that unlike special agent, the authority of a general agent is continuous unless it is terminated.

A general agent is not the same thing as an universal agent. An universal agent can do all such things which the principal can lawfully do and delegate. He is authorised to transact all the business of his principal of every kind. He has an unlimited authority to bind the principal.

On the basis of nature of work

The most important classification of agents, however, is based on the nature of work performed by them. They can be classified as i) mercantile or commercial agents, and ii) non-mercantile or non-commercial agents. **Mercantile agents** may be of several kinds, e.g., brokers, factors, auctioneers, del credere agents, commission agents, insurance agents; bankers. **Non-commercial agents** may be estate agents, house agents, lawyers, election agents, etc. Here we are mainly concerned with mercantile agents who are explained below.

a) **Broker**: A broker is one who makes bargains for another, and receives commission (brokerage) for so doing. He is an agent whose ordinary course of business is to negotiate and make contracts for the sale and purchase of goods etc., of which he has neither possession nor control. He acts in the name of his principal.

b) **Factor**: A factor is a person who is entrusted with the possession of goods, and who has the authority to buy, or sell or otherwise deal with the goods or merchandise, or to raise money on their security. A factor, usually, sells goods in his own name, he has a general lien on the goods.

c) **Auctioneer**: An auctioneer is an agent who is entrusted with the possession of goods for sale to the highest bidder at a public auction. He has the authority to deliver the goods on receipt of the price. He can sue for the price in his own name. However, unlike a factor, he has only a particular lien on the goods for his charges.

d) **Del Credere Agent**: A del credere agent is one, who in consideration of an extra remuneration called the Del Credere Commission, guarantees to his principal that the third person with whom he enters into contracts shall perform their obligations. Thus such an agent guarantees to his principal the payment of the price.

e) **Commission Agent**: A mercantile agent who buys and sells goods on behalf of his principal and receives commission for his services. Actually, it is not a different category agent because brokers, factors may also act as commission agent.

f) **Banker**: Generally, the relationship between a banker and customer is that of a creditor and debtor. However, when he collects cheques or buys or sells securities on belief of his client, he acts as an agent of the customer. A banker has the right of general lien in respect of the general balance of account.

11.7 SCOPE AND EXTENT OF AUTHORITY

An agent authority may be (a) Ostensible or apparant authority (b) Actual or real authority (c) Authority in emergency/by necessity.

An agent has the authority to do all things necessary for carrying out the particular purpose for which he has been appointed. When a person is held out as an agent for a particular purpose or business, persons dealing with him are entitled to presume that he has the authority to do all such acts as are necessary or incidental to such a business. Such authority is called apparent or ostensible authority of the agent, as distinguished from actual or real authority. Actual authority is created by agreements to which the principal and agent alone are parties.

It is ostensible authority that determines the scope of an agent's authority. The ostensible authority of an agent may be curtailed by his principal. The Indian law is laid down in Sections 188 and 237 as follows:

An agent having an authority to do an act has authority to do every lawful thing which is necessary in order to do such act. An agent having an authority to carry on a business has authority to do every lawful thing necessary for the

purpose, or usually done in the course of conducting such business (Section 188). For example, A employs B as his agent to carry on his business of a ship-builder. B may purchase timber and other materials, and hire workmen for the purpose of carrying on the business.

"*When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of the agent's authority*" (Section 237). For example, A consigns goods to B for sale, and gives him instructions not to sell below a fixed price. C, being ignorant of A's instructions enters into a contract with B to buy the goods at a price below the reserved price. A is bound by the contract.

Though the scope of authority of an agent under normal circumstances is defined in Section 188, still, in cases of emergency he would have larger powers and Section 189 therefore enacts as follows: "*An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances*". In such cases the authority is deemed to be conferred by what has been described above as agency by necessity. In **Sims & Co. v. Midland Rail Co.,** where butter which was in danger of becoming useless owing to delay in transit was sold by the railway company for the best available price and it was found that it was impossible to obtain instructions of the principal, the sale was held binding upon the principal.

11.8 DELEGATION OF AUTHORITY BY AGENT

An agent, being himself a person who has got delegated authority from the principal, cannot further delegate except with the permission of the principal. This is expressed by the Latin maxim 'delegatus non potest delegate': a delegate cannot further delegate, i.e., one cannot delegate that which one has himself undertaken to do. Agency is a matter of trust and confidence and an agent is appointed only because the principal has got full confidence in his integrity or ability. So, the agent cannot without the permission of the principal, delegate his authority and ask some other person to do the work. To this rule the following are the exceptions:

i) where the duties of the agent do not require any skill or discretion, and can satisfactorily be performed by any one;

ii) where the custom of the trade permits delegation;

iii) where the principal knows that the agent intends to delegate;

iv) where the nature of the business requires delegation;

v) where an emergency makes it necessary to delegate.

An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally, unless by ordinary custom of trade a sub-agent may, or, from the nature of the agency, a sub agent must be employed. A legal practitioner is permitted by the usage in the profession, to authorise any other practitioner to appear

for him. But, in cases in which he has expressly undertaken to appear personally, he has no such right to delegate his authority.

Sub-agency

Where an agent having authority expressly or impliedly to delegate his authority appoints another person to act in the matter of the agency, such other person is called a 'sub-agent', provided he acts under the control of the original agent; and a 'substituted agent, if the original agent drops out of the transaction and the newly appointed person carries on the business of the agency.

Relationship between principal and sub-agent: You have seen that in certain circumstances an agent can appoint a sub agent. In such cases the principal is bound by the acts of the sub-agent, since the sub-agent is not responsible to the principal but he is responsible for his acts to the original agent only. The principal cannot take action against sub-agent, except in cases of fraud or wilful wrong. As between the original agent and the sub-agent, the relationship is that of the principal and agent.

In case the appointment of a sub-agent is not proper, the principal shall not be bound by the acts of the sub-agent. The original agent will, in such cases, be personally liable to both the principal as well as the third parties for the acts of the sub-agent. In such cases, the sub-agent is not responsible to the principal for any of his acts.

11.9 SUB-AGENT AND SUBSTITUTED AGENT

A sub-agent has been defined by Section 191 of the Indian Contract Act: "*A sub-agent is a person employed by and acting under the control of the original agent in the business of the agency". A substituted agent is defined by Section 194 thus: "Where an agent, holding an express or implied authority to name another person to act for the principal in the business of agency, has named another person accordingly, such person is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted by him*".

Thus the main difference between the two is that an agent not only appoints a sub-agent but the sub-agent works under his control, and the agent himself is liable for the acts of the sub-agent. But in case of substituted agent the duty of the agent ends with appointing or naming a particular person for being appointed as a "substituted agent". The moment the substituted agent is appointed, privity of contract is established between him and the principal, and the original agent disappears from the scene altogether. The care that ought to be exercised by an agent in selecting a substituted agent is that which a man of ordinary prudence would exercise in his own case.

Check Your Progress A

1. Define an agent.

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2. What is implied agency?

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3. Can an agent exceed his authority in an emergency?

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4. Who is a sub-agent?

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5. What is meant by implied authority of an agent?

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6. State whether the following statements are True or False:

   i) An agent is not different from a servant. ( )

   ii) A servant is different from an independent contractor. ( )

   iii) A minor may be an agent. ( )

   iv) A contract of agency may be created expressly but not impliedly. ( )

   v) There is no privity of contract between a substituted agent and the principal. ( )

   vi) The principal is liable for all the acts of his agent. ( )

   vii) In general, a sub-agent is not directly under the control of the principal. ( )

   viii) A gratuitous contract of agency is invalid. ( )

7. How would you decide the following cases:

   i) B tells C in the presence and within the hearing of A that he (B) is A's agent in A's business and A does not contradict the statement. Subsequently, C enters into a transaction with B bona fide believing that B is A's agent. Is the principal liable under that contract even when in fact B is not A's agent?

   ii) A permits his agent B to purchase goods from C for credit. By using the authority B made credit purchases from C for his own case. Is the principal A liable to C?

iii) A, an advocate, delegated by the usage in the profession another practitioner 'B' to appear for him in the court. 'B' accordingly appeared. The case was lost. The client held A responsible. Is 'A' responsible?

iv) Z instructs his lawyer in another town to engage an estate agent to sell his house in that town. As per instructions, the lawyer selects B, the leading estate agent of the town, for the purpose. B is able to sell the house for a good price, but B delays to remit the purchase amount to Z and meanwhile becomes insolvent. Z holds his lawyer responsible for the loss. How would you decide this case? State your reasons.

11.10 AGENCY BY RATIFICATION

Sometimes a person may act for another person without any express or implied authority from that other person. The person in whose name the act has been done may either disown the act of that person or may approve the actions. This act of affirmation by the person in whose name the act has been done is known as "ratification". For example, A may act as B's agent although A has no prior authority from B. When B comes to known of it, he may either disown the acts of A or may subsequently accept them. The effect of ratifying the unauthorised act is that it places the parties in that position in which they would have been if the agent had principal's authority at the time he made the contract. Similarly, where an agent exceeds his authority, the principal may either reject it or accept it. If the principal accepts the work done by agent, he will be liable for the acts of the agent. For example, A appointed B as his agent to buy wheat for him. In addition to buying wheat, B buys 10 bags of rice for A. Afterwards, A agrees to take the delivery of rice as well. A is liable to pay the price of rice. This is a case of ratification of unauthorised acts. Section 196 of the Contract Act provides *where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as they have been performed by his authority*. Further, Section 197 provides that ratification may be express or may be implied in the conduct of the person on whose behalf the acts are done. For example, A, without authority, buys goods for B. Later on, B sells those goods to C and deposits the sale proceeds in his bank account. B's conduct implies a ratification of the purchase made by A.

Here you should note that ratification relates back to the date when the act was done by the agent, i.e., **it tantamounts to prior authority**. Hence the relationship of agency shall be deemed to have come into existence from the time the agent first acted and not from the time when the principal ratified the act. For example, in **Bolton Partners v. Lambert** the managing director of a company, without prior authority from the company, but acting on behalf of the company, accepted an offer made by B. B, later on, revoked the offer but the company ratified managing director's acceptance. It was held that because ratification relates back to the time of acceptance by managing director, B is bound by ratification and he cannot revoke his offer.

Essentials of a valid Ratification: You have learnt that an agency may be created by ratification. However, for a valid ratification, following conditions should be fulfilled:

1) **The agent must act on behalf of another person who is identifiable**: When the agent enters into a contract, he should expressly contract as an agent. Further, the contract should specify an identifiable person as principal. For example, A representing himself to be an agent of B, but without authority or knowledge of B, entered into a contract with C to buy 100 bales of cotton on behalf of B. Subsequently, the prices of cotton bales go up. B on becoming aware of the transaction purported to have been done on his behalf, ratifies it. C refuses to perform the contract. B can compel C to perform the contract. If the purported agent does not mention that he is acting on behalf of another person, although in his mind he might be contemplating to act on behalf of the purported principal, such act cannot be ratified. It follows that acts done by the agent in his own name cannot be ratified later on.

2) **Existence of the principal**: For valid ratification it is necessary that the principal should be in existence at the time of when the act is done in his name. It is for this reason that when the promoters of a new company enters contracts for the company which has not yet come into existence, the company cannot ratify such contracts, when contract was entered into, the company (principal) was not in existence.

3) **Principal should be competent to contract at the time when the act was done as well as at the time of ratification**: For a valid ratification it is necessary that the principal should be competent to contract when the contract was made and also at the time of ratification. You would recall that a minor is not competent to contract, hence on attaining majority he cannot ratify the contracts made on his behalf during his minority.

4) **Full knowledge of all relevant fact**: No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective (Section 198). For valid ratification it is necessary that the ratifier should have the full knowledge of the acts of the case. For example, A employs B to take a house on reasonable rent in Delhi. B lets out his own house at a rent which is much higher than the prevailing rentals in that area. A starts living in the house. Later on, A comes to know that the house belonged to B. A's ratification is not binding upon himself.

5) **Within reasonable time**: The ratification must be done without any unreasonable delay. If the ratification is not done within reasonable time, it will not be binding.

6) **Ratification must be of whole transaction**: The ratification must be made for the whole transaction. A ratifier cannot ratify a part which is beneficial to him and reject the rest. When a person ratifies part of the unauthorised transaction, it is treated as the ratification of whole transaction (Section 199).

7) **No damage to third party**: Section 200 puts a restriction on the power of the ratifier. It says, *An act done by one person on behalf of another, without such other person authority, which if done with authority, would have the effect of subjecting a third person, to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect*. So any ratification which might cause any damage to third party or terminate any right or interest of a third party cannot be ratified.

For example:

i) A is in possession of a cow belonging to B. C without authority from B demands on behalf of B, the delivery of that cow. A refuses to deliver the cow to C. B cannot ratify the demand made by C so as to make A liable for damages for A's refusal to deliver the cow.

ii) A holds a plot of land, which was leased to him by the owner B. The lease was terminable on three months notice. C, an unauthorised person, gives notice of termination of lease to A. B cannot ratify the notice so as to be binding on A.

8) **Act to be ratified must be lawful**: Only those acts can be ratified which are valid and lawful. An act which is void, unlawful or illegal cannot be ratified. For example, A forged B's signature and withdrew some money from Bank. Subsequently, B ratifies A's act of withdrawing money. The ratification is not valid as forgery is an offence.

9) **Act to be ratified should be within the power of the principal**: The principal can ratify only such acts which are within his power. Hence an act which is beyond the competence of principal cannot be ratified. For example, if the director of a company does an act on behalf of the company which is ultra-virus the company, the principal (company) cannot ratify such act. Besides, to be valid the ratification must be communicated to the concerned party.

11.11 RIGHTS OF AN AGENT

1) **Right to Receive Remuneration (Section 219 and 220):** You know that an agent is a person employed to do any act for another, and for his services, he is entitled to receive remuneration. The amount of remuneration shall be such as may be fixed by the terms of agency. In case the remuneration has not been fixed, the agent is entitled to receive a reasonable remuneration. In the absence of a contract to the contrary, agent's right to receive remuneration would accrue only on the completion of the work. An agent is entitled for his remuneration when he has done what he had undertaken to do, even though the contract is not completed. For example, A was appointed as an agent by an export organisation to secure export orders. A secured some orders for the firm, but firm was dissolved. A is entitled to his commission, though the orders secured by him have not been executed. Section 219 provides that *in the absence of any special contract, payment for the performance of any act is not due to the agent until the completion of such act, but an agent may detain money received by him on account of goods sold although the whole of the goods consigned to him for sale may not have been sold, or although the sale may not be actually complete.*

   So the pertinent question arises, when is the act complete? This is a question of fact depending upon the facts and circumstances of each case. But it is necessary that the transaction (act) should be the direct or indirect result of efforts of the agent. For example, A, a factory owner, employs a broker B, to arrange some raw material for A's factory. B introduced the supplier of that raw material to A. The supplier demanded some advance money which A was unable to pay. Later on, A directly contacted the supplier

and entered into a contract for supply of raw material. B is entitled to his remuneration. However, under Section 220, an 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 mis-conducted. For example, A employs B to recover Rs. 20,000 from C and to invest the money in good securities, B recovers the money from C, invests Rs. 15,000 in good securities and Rs. 5,000 in securities which he ought to have known to be bad, whereby A loses Rs. 1,000. Here B is entitled to remuneration for recovering Rs. 20,000 and for investing Rs. 15,000. He is not entitled to receive any remuneration for investing Rs. 5,000 and he must make good the loss of Rs. 1,000 to A.

2) **Right of Retainer**: Section 217 of the Contract Act empowers the agent to retain, out of any sums received on account of the principal in the business of the agency for the following payments:

   a) all moneys due to himself in respect of advance made,

   b) in respect of expenses properly incurred by him in conducting such business, and

   c) such remuneration as may be payable to him for acting as agent.

3) **Right of Lien (See 221)**: You have just now noted that the agent may retain principal's money until his proper payments have been made. Agent has another right i.e., right to retain his principal's goods, papers and other movable or immovable properties received by him until he is paid or accounted for his commission, disbursements and service charges. This lien of the agent is the particular lien. The right of lien has the following limitations:

   a) This right is available to the agent if there is no contrary to the contract.

   b) This right is available on those properties which have come into agent's possession lawfully. If the agent obtains possession by unlawful means, say by misrepresentation, or without authority from the principal, the agent cannot exercise lien.

   c) The lien is only a particular lien, By particular lien we mean that the agent can detain only such goods in respect of which some remuneration is due.

   d) Right of lien can be exercised subject only to all rights and equities of third parties against the principal. For example, if the agent has sold certain goods belonging to his principal, he cannot refuse to deliver the goods to the buyer.

   e) Since the lien is a possessory right, it cannot be exercised once the possession is lost.

4) **Right to be Indemnified**: Sections 222 and 223 grant right to indemnify to an agent against his principal for the consequences of all lawful acts done by the agent in performing his obligations. Section 222 provides, *the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him*. For example, B at Singapore, under instructions from A of Calcutta contracts with C to deliver certain goods to him. A does

not send the goods to B, and C sues B for breach of contract. B informs A of the suit, and A authorises him to defend the suit. B defends the suit, and is compelled to pay damages and costs, A is liable to B for such damages, costs and expenses.

Agent's right to be indemnified extends even for those acts which are apparently lawful but are in fact unlawful or injurious to a third person. However, the right to indemnify is not available against those acts which on the face of it are unlawful or are criminal in nature, even if there is an express or an implied promise to indemnify the agent against the consequences of that act. For example, A employs B to put to fire C's growing crop and agrees to indemnify B against all consequences of the act. B, accordingly put to fire, B's growing crop and is made to pay damages to C. A is not liable to indemnify B.

Where one person employs another to do an act, which may cause an injury to the rights of a third person and the agent does the act in good faith, the principal is liable to indemnify the agent. For 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 the goods, sues B and recovers the value of 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.

5) **Right to Compensation**: The agent has the right to receive compensation for the injuries or losses suffered due to the principal's neglect or want of skill (Section 225). For example, A employs B as a brick layer in building a house, and puts up the scaffolding himself. The scaffolding is unskilfully put and B is, in consequence, hurt. A must pay compensation to B. It should however, be noted that if the injury is caused by the negligence of the agent himself, then he cannot claim any compensation.

11.12 DUTIES OF AN AGENT

Following are the statutory duties of the agent:

1) **Duty to Act According to the Instructions or Custom of Trade**: Section 211 lays down that it is the duty of an agent to conduct the business of the agency strictly according to the directions given by the principal. For example, if an agent is asked by his principal to insure the goods, the agent failed to do so and the goods are destroyed by the fire. The agent is liable to compensate the principal for the loss.

   However, when the principal has not given any directions, in that case the agent should conduct the business according to the custom of the trade. For example, B, a broker in whose business it is not the custom to sell goods on credit, sells goods of his principal on credit. Before making the payment, the buyer becomes insolvent. The broker, B is liable to pay for the loss.

   When the agent acts otherwise, if any loss incurred, the agent must make it good to the principal, and if any profit accrues, the agent must account for it. For example, A, the principal, instructed his agent B to put certain goods in a particular warehouse. Ignoring A's directions, B puts the goods

in another equally safe warehouse. The goods were destroyed by fire without any negligence on the part of B. Here the agent was held liable to make good his principal's loss.

2) **Duty to Act with Reasonable Care and Skill**: It is the duty of an agent to conduct the business of the agency with reasonable care and skill. The degree of care and skill required from the agent depends upon the nature of business and circumstances of each case. For example, A, living in Mumbai asked B at Delhi, to collect Rs. 10,000 from C. B collects the money and sends the amount by bank draft, placed in a letter sent by register post to A. B has done his duty as a man of ordinary prudence would have done in his own case. However, if instead of sending the draft by registered post, B sends the draft by ordinary post, B would be responsible for acting negligently.

   The agent is required to act with reasonable diligence, to use skill as he possesses and to compensate the principal in respect of the direct consequence of agent's own neglect, want of skill or misconduct. For example, A, an insurance broker, was employed by B to effect an insurance on a ship. A insured the ship but failed to see that 'usual clauses' are inserted in the policy. The ship was lost in storm. Due to omission of the 'usual clauses' in the policy, nothing could be recovered from the Insurance company. A is liable lo make good the loss suffered by B.

   It follows from the above that the agent is not liable to compensate the principal in respect of loss or damage which are indirect or remotely caused by such neglect, want of skill, or misconduct.

3) **Duty to Render Accounts**: An agent is bound to render proper accounts to his principal on demand and to pay overall sums received on principal's behalf subject to any lawful deduction for remuneration or expenses properly incurred by him.

4) **Duty to Communicate with the Principal**: Section 214 enjoins an agent, in case of difficulty, to use all reasonable diligence in communicating with his principal, and in seeking to obtain his instructions.

5) **Not to Deal on His Own Account**: An agent is not to deal on his own account in the business of Agency, as no agent *is permitted to put himself in the position where his interest conflicts with his duty*. If an agent desires to deal on his own account in the business of agency, he must make a full and frank disclosure of all the material circumstances, which have come to his knowledge on the subject, to the principal and obtain his consent (***Lever Bros. v. Bell***). If, however, he fails to obtain such consent, and carries on the said business on his own account, or after giving the consent, the principal finds that either any material facts has been dishonestly concealed from him by the agent to his interests, the principal has two options. He may (i) repudiate the transactions entered into by agent and disclaim all losses, or (ii) claim from the agent benefit resulting from the transaction. For example, A directs B to sell his estate. B, on looking over the estate before selling it, finds a mine on the estate which is unknown to A. B informs A that he wishes to buy the estate for himself, but conceals the discovery of the mine. A on discovering that B knew of the mine at the time he bought the estate, may either repudiate or adopt

the sale at his option, Take another example. A directs B, his agent, to buy a certain house for him. B tells A that the house cannot be bought and buys the house for himself. A may, on discovering that B has bought the house, compel him to sell it to A at the price he (B) gave for it.

6) **Not to Use Information Obtained in the Course of the Agency against the Principal**: Where an agent has obtained information during the course of the agency, it is the duty of the agent not to use the same prejudicially to the interests of the principal. Where an agent does make use of such information, the principal may restrain him from doing so by an injunction.

7) **Not to Set Up Adverse Title**: Where an agent has obtained goods or property from the principal as an agent, it is his duty not to set up his own title or the title of a third person. In other words, the agent should not dispute the ownership of the principal.

8) **Not to Make Secret Profits**: As you know that the relationship of principal and agent is based on mutual confidence, it is the agent's duty not to make any secret profits in the business of agency. For example, A appointed B, an auctioneer to sell certain goods belonging to him. B sold the goods to C, and received some secret commission from C in addition to the commission from A. It was held that B was bound to hand over the secret commission to A.

9) **Duty to Exercise His Authority Personally**: Section 190 of the Act requires an agent to perform acts personally which he has expressly or impliedly undertaken to perform personally. In other words, an agent must not delegate the authority given to him. However, under certain circumstances, this authority can be delegated (discussed in 11.8).

10) **Duty on the Death or Insanity of the Principal**: Section 209 requires that when an agency is terminated by the principal dying or becoming of unsound mind. the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interests entrusted to him.

Rights and Duties of Principal towards Agent

As should be clear to you from what you have studied so far that the rights of the principal are the duties of the agent and duties of the agent are the rights of the principal.

Check Your Progress B

1. What is agency by ratification?

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2. 'Ratification is tantamount to prior authority' Explain.

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3. Enumerate the conditions that are necessary before exercising a lien.

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4. Can an agent have the business dealing on his own account? If not, why?

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5. State whether the following statements are True or False:

   i) X, without Y's authority lends Y's money to Z . Afterwards Y accepts interest on the money from Z. Y's conduct does not imply a ratification of the loan. ( )

   ii) The act of the agent to be ratified must be valid in itself and not illegal. ( )

   iii) A forgery of signature, though ratified, conveys no title. ( )

   iv) A person cannot ratify a part of the transaction. ( )

   v) An agent who is guilty of misconduct in the business of agency is not entitled to any remuneration. ( )

   vi) The lien existing in favour of the agent is generally a particular lien. ( )

   vii) For a valid ratification the principal must be competent to contract at the time or ratification. ( )

   viii) Where the agent smuggled goods and paid for them, the principal can be compelled to indemnify the agent. ( )

   ix) An agent must not put himself in a position where his duty to the principal and personal interest conflicts. ( )

11.13 PERSONAL LIABILITY OF AN AGENT

Ordinarily in a contract of agency, an agent being a person employed to create relationship between his principal and the agent, the agent can neither enforce the contract personally nor is he personally liable on the contract unless there is a contract to the contrary provides. *In the absence of any contract to that effect, an agent cannot personally enforce contracts entered into by him on behalf of his principal, nor is he personally bound by them. Such a contract shall be presumed to exist in the following cases*:

i) Where the contract is made by an agent for the sale or purchase of goods for a merchant resident abroad;

ii) Where the agent does not disclose the name of his principal;

iii) Where the principal, though disclosed, cannot be sued.

However, there are circumstances when the agent becomes personally liable. These are as follows:

1) **When the Agent Expressly Agrees**: Sometimes the third party when contracting with an agent may specifically stipulate that the agent will be personally liable if the contract is not performed, in such a situation the agent will be personally liable. For example, A , an agent entered into an agreement with B to grant a lease of a house. In the lease deed it was mentioned that A was acting as an agent of the owner of the house C. However, in the subsequent portion of the lease deed it was provided that the agent would execute the lease. In this contract the agent will be personally liable if the contract is not performed: although the house belonged to C. Similarly, auctioner of property signing agreement of sale in their own name without qualification must be understood to contract personally and not as agents.

2) **When Acting for a Foreign Principal**: Where an agent enters into a contract for a foreign principal (a merchant residing abroad), the presumption is that the agent is personally liable for such contracts. This presumption came into existence because in earlier times it was difficult to sue foreign principal, hence it became customary that when the agent is entering into a contract on behalf of a foreign principal, the agent would be personally liable. But now because of changed atmosphere of international trade, although the rule still exists, but the agent do not undertake personal liability and the contracts are entered manifestly laying that the liability would be that of the principal if the contract is not performed.

3) **When Acting for an Undisclosed Principal**: When a contract is made by an agent for an undisclosed principal, the agent is personally liable. The reason for it is that because the third party while making the contract, relied upon the credit of the known agent and consequently, the agent becomes responsible for the transactions.

4) **Where the Principal though Discovered cannot be Sued**: When the agent enters into a contract on behalf of a person who cannot be sued, as for example, where the principal is a foreign sovereign or an ambassador, or a minor or a lunatic, the presumption is that the third party gave credit to the agent, hence the agent is personally liable upon the contract.

5) **When Principal is a Company which is yet to Come into Existence**: When the promoters of a company enter into any contract on behalf of a company not yet incorporated, the promoters are personally liable for the obligation they create by any contract with any one. The reason for this is that the company, being not in existence at the time of formation of contract, cannot be sued.

6) **When Agent's Authority is "Coupled with Interest"**: Where an agent has a special interest in the subject-matter of the contract, his authority is said to be coupled with interest. He is really a principal to the extent of his interest and may sue in his own name or be sued but only to the extent of his interest in the subject matter. For example, M authorises N to sell his land and out of the sale proceeds to pay himself the debts due to him from M. N's authority is coupled with interest.

7) **When There is a Custom or Trade Usage**: An agent may be held personally liable on contract entered by him, if there is some trade usage or custom, provided there is no contract to the contrary. For example, in the business of stock exchange it is a custom that a broker is personally liable for the contracts entered into by him, so a jobber may hold the broker personally liable.

8) **Money Paid by Mistake or Fraud**: When a person untruly represents himself to be the authorised agent of another and thereby induces a third party to deal with him as such agent, or the agent exceeds his authority, and the (alleged) principal does not ratify his acts, the alleged agent is personally liable to the third party and the third party may recover from him compensation in respect of any loss or damage suffered by them (Section 235).

9) **When He Enters into Contract in his Own Name**: If an agent enters into contract with the third party in his own name i.e., without disclosing that he is contracting as an agent. For example, A took a loan from B and executed a hundi in his favour. The hundi appeared to be drawn by a firm. A did not sign the hundi as agent of the firm nor did he disclose to B the name of the principal who was the proprietor of the firm. The agent was held personally liable on the hundi.

In case where the agent is personally liable, a person dealing with him may either hold him or his principal or both of them liable (Section 233).

11.14 LIABILITY OF PRINCIPAL TO THIRD PARTIES

You have learnt that an agent enters into a contract with third parties on behalf of his principal, i.e., the principal is liable to third parties for the acts of the agent. The liability of the principal to third parties may be studied under the following heads:

1) Where the name and existence of the principal is disclosed by the agent to the third party.

2) Where the name is not but principal's existence is disclosed or where we may conveniently say that the principal is unnamed, and

3) Where the principal is undisclosed i.e., neither the existence nor the name of the principal is disclosed.

1) **Liability of the Principal where Both the Existence and Name of Principal is Disclosed.**

   a) Since the agent is employed for bringing about the contractual relations between the principal and the third parties, contracts entered into by the agent bind the principal to the same extent, as if they had been made by the principal himself (Section 226).

   b) The principal is generally liable for such acts of the agent which are within the scope of his authority. But if the principal gives the authority to represent him in a particular business, then the principal is bound by ever such act of the agent which is incidental to such business

or which falls within the apparent scope of the agent's authority or as it is often called the "ostensible authority" of the agent. Where a principal while conferring authority upon an agent imposes conditions or limits the authority, the principal shall be liable for such acts which are in excess of the authority, only when the other party is not aware of the limitations. For example, where A authorises B to sell goods, but privately instructs him not to sell on credit but B sells them to C on credit, who does not know of the restrictions, the sale is binding upon A.

When the agent exceeds the authority given to him, the principal has the option that he may either disown or accept it. In case the work where the agent has exceeded his authority can be separated from that part which falls within his authority, the principal is bound by the authorised work only (Section 227). For example, A being the owner of a ship and the cargo in it, authorises B to procure an insurance for Rs. 5,000 on the ship. B procured a policy of Rs. 5,000 on the ship and another policy for the like sum on the cargo. A is bound to pay the premium for the policy on the ship only, but he is not bound to pay the premium for the policy on the cargo.

c) If the unauthorised portion cannot be separated from the authorised one, the principal may repudiate the whole transaction (Section 228). For example, an agent is authorised to buy 100 pants. The agent, in addition to buying 100 pants, buys 100 shirts also for Rs. 10,000, the principal will not be liable and he may repudiate the whole transaction.

d) Any information which is material for the business of the agency if brought to the notice of the agent is deemed to have been brought to the notice of the principal. Section 229 accordingly provides that any notice given to or information obtained by the agent in the course of the business transacted by him for the principal shall, as between the principal and third parties, have the same legal consequences as if it had been given to or obtained by the principal. For example, A is employed by B to buy from C certain goods of which C is the apparent owner. In the course of negotiations, A learns that the goods actually belong to D and C is the agent only. B is not aware of this fact. B had some claim against C which he wanted to set off against the price. Now B cannot set off his claim because the goods belong to D and not to C. Here the knowledge of the agent is treated as the knowledge of the principal.

e) If during the course of the business of agency, the agent makes any misrepresentation or commits any fraud, it will have the same effect on the agreement as if they have been committed by the principal. For example, A, being B's agent for the sale of sugar, induces C to buy it by a misrepresentation. The contract is voidable, as between B and C, at the option of C. However, if the misrepresentation is made or fraud is committed by the agent, in matters which do not fall within agent's authority, the principal is not liable (Section 238).

2) **Liability where only the Existence of the Principal has been Disclosed but not His Name (Unnamed Principal)**: If the agent while contracting with third parties discloses the fact that he is entering into the contract on behalf of his principal but does not discloses the name of the principal, the principal is bound by the contract. However, such acts must be within the scope of agent's authority and the unnamed principal must be in existence at the time of entering into the contract. For such contracts, the agent is not personally responsible unless there is something which shows that he agreed to be personally liable. But if the agent refuses to disclose his principal's identity when asked by third parties, then, the agent becomes personally liable.

3) **Undisclosed principal**: Sometimes, the agent contracts with a third party without disclosing the name and existence of the principal. He gives an impression as if he is independently making the contract, whereas, in fact he has entered into the contract on behalf of his principal, but the third party neither knows nor has reason to suspect that the person with whom they are dealing is an agent. In such a situation the principal remains undisclosed and may be called as an undisclosed principal. Mutual rights and liabilities of principal and agent in this case are as follows:

   i) Because the agent has entered into the contract in his own name, therefore, the third party can hold him personally liable on the contract. The agent can be sued by the third party and he can sue third party as well, So far as his rights against the principal are concerned, he continued to enjoy all the rights of an agent against the principal.

   ii) If the third party discovers that there is a principal, the third party has the option to sue the agent or the principal or both. This option is available to the third party, if it had already not obtained any judgement against the agent. If the third party decides to file a suit against the principal, he must allow the principal the benefit of all payments received by him (third party) from the agent. For example, A, an agent, without disclosing his principal, enters into a contract with B to buy certain goods for Rs. 10,000 and pays Rs. 500 as advance. In fact, A was acting as the agent of C. In case the contract is not performed, B (third party) may sue C, but B will have to give the credit of Rs. 500 which he (B) received from A.

   It should be noted that the third party has to make a choice to sue either the principal or the agent or both. However, once the choice has been made, then he cannot sue the other (Section 234).

   iii) Section 231 of the Act provides that if the principal discloses himself before the contract is completed, the other contracting party may refuse to fulfil the contract. But this can be done only if he can prove that, if he had known 'who was the principal in the contract or if he had known that the agent was not a principal, he would not have entered into the contract. For example, in **Said v. Butt** case through an undisclosed agent, A bought for himself a ticket of theatre because on personal grounds theatre management would not have issued the ticket to A. Theatre owner may repudiate the contract and refuse A to enter the theatre hall.

iv) Where one person enters into a contract with other neither knowing nor having any ground to suspect that the person with whom he has entered into contract is an agent, the principal, if he requires the contract to be performed, can obtain such performance subject only to the rights and obligations subsisting between the agent and the other party to the contract (Section 232). For example A, who owes Rs. 1,000 to B, sells Rs. 2,000 worth of rice to B. A is acting as agent for C in the transaction, but B has no 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.

If there exists some express or implied term in the contract, the undisclosed principal cannot intervene. For example, if in a contract of sale of 100 quintals of woods the agent describes himself in the contract as the owner, such manifestation precludes the principal because it shows an intention to make a personal contract. However, the principal may be allowed to intervene and may be allowed to show that he is in fact the principal. For example, A lets out his flat to B through a property agent C. In the contract the agent described himself as the owner of the flat. The undisclosed principal may contradict it.

11.15 TERMINATION OF AGENCY

Except in those cases where the agency is irrevocable, the agency may be terminated in any of the ways mentioned in Section 201 which reads: *An agency is terminated by the principal revoking his authority; or by the agent renouncing the business of the agency or by the business of the agency being completed; or by either the principal or agent dying or becoming of unsound mind; or by the principal being adjudicated an insolvent under the provisions of any act for the time being in force for the relief of insolvent debtors.*

So from the above description (see Figure 11.2) you will see that the agency may be terminated either (1) by act of the parties, or (2) by operation of law,

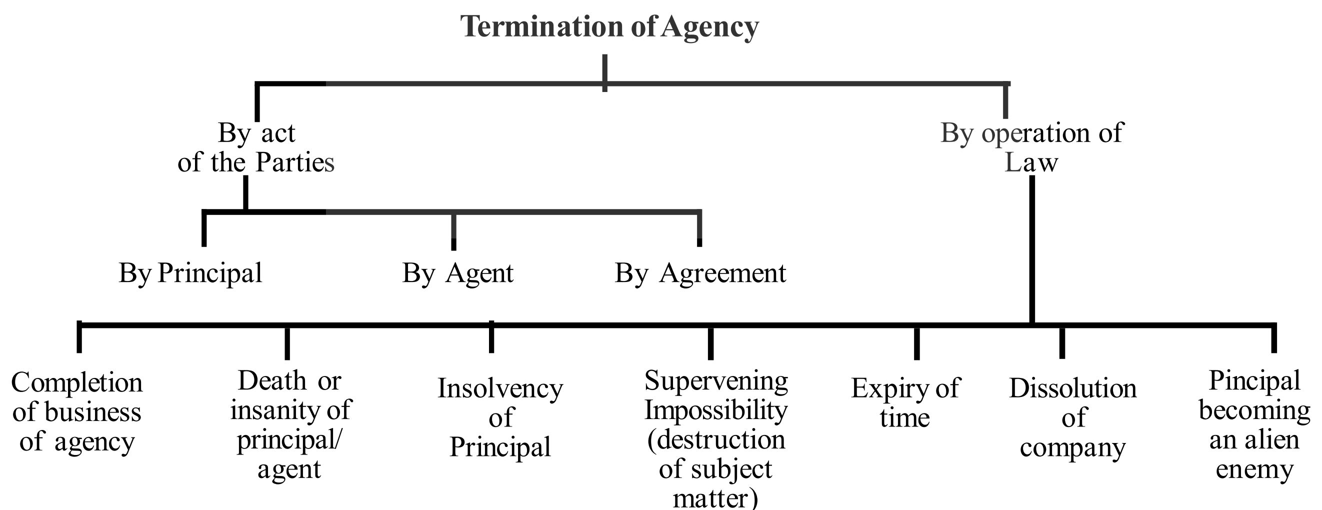

Fig. 11.2

By Act of the Parties

i) **By Principal**: As you have already noted that the principal may revoke the authority of his agent at any time before the authority has been exercised

so as to bind the principal. So the agency may be terminated if the principal revokes his authority. But if the agent has partly exercised his authority, the principal may revoke agency for future acts only. Where the agent has some personal interest in the business of agency, the agency cannot be terminated (This point is discussed in detail in Section 11.16 of this unit). Section205 provides that, where there is an express or implied contract that the agency should be continued for any period of implied contract that the agency should be continued for any period of time, and any party, without any sufficient cause terminated the contract before the stipulated time, the defaulting party must make compensation to the other party for revocation or renunciation. If the agency is to continue for a fixed period of time, the principal must give a reasonable notice to the agent before terminating the agent's authority. If such a notice is not given, the principal shall be liable to compensate the agent for any loss suffered by him.

ii) **By Agent**: The agency may be terminated even by agent himself renouncing the agency, after giving a reasonable notice to the principal. Section 206 stipulates that reasonable notice must be given of revocation or renunciation of agency otherwise the defaulting party is liable to pay damages resulting to the other party. Revocation and renunciation may be either express or implied. For example, A employs an agent B to sell his car. Later on, A sells the car himself. This is an implied revocation of agent's authority.

iii) **By Agreement**: The agency, like any other agreement may be terminated, at any time, by mutual agreement between the principal and the agent.

By Operation of Law

The relationship of principal and agent may be terminated by operation of law, under any of the following circumstances:

i) **Completion of the business of agency**: An agency is automatically terminated as soon as the business of agency is completed. For example, A employs B to sell his car. The agency will be terminated when the sale is completed.

ii) **Death or insanity of principal or the agent**: The relationship of principal and agent is terminated when the principal or agent dies or becomes of unsound mind. Section 209 imposes a duty upon the agent by providing that even after the death of his principal and consequent termination of agency, with a view to protect the interest of his deceased principal, the agent is bound to take, on behalf of the representatives of his late principal all reasonable steps for the protection and preservation of the interests entrusted to him.

iii) **Insolvency of the principal**: When the principal becomes insolvent, the agency too is automatically cancelled. The reason being that insolvent person is disqualified from entering into contract in respect of his property.

iv) **Destruction of subject matter**: When the subject matter of the contract cease to exist, any contract relating to that subject matter also comes to an end. Consequently, any agency created to deal in that subject matter is also terminated by the total destruction of the subject matter. For example, A employs an agent B to sell his car. The car meets with an accident and becomes unsaleble. The agency terminates after the accident.

v) **Expiry of time**: When an agent is appointed for a fixed period, the agency terminates after the expiry of the stipulated time, unless the term of agency has been extended. The agency is terminated even though the business of the agency has not been completed.

vi) **Dissolution of the company**: If the principal or the agent is a company and the company is dissolved, the agency also automatically comes to an end on such dissolution.

vii) **On principal becoming an alien enemy**: If a contract is entered between a principal and an agent who are citizens of two different countries and a war breaks out between the two countries, the agency is terminated because the consequence of war is that the citizens of belligerent countries become alien enemy and the contract of agency becomes unlawful.

Effective Time of Termination of Agency

When does termination of agency take effect? The law in this regard is laid down in Section 208 and is as follows:

1) The authority of an agent, so far as he is concerned, comes to an end only when the agent comes to know that his authority has been terminated.

2) Likewise so far as third parties are concerned, the authority of the agent will be terminated only when they come to know that the authority has been revoked. In simple words, it can be stated that the termination is effective from the time when it comes to the knowledge of the agent or third parties. Thus, termination may be effective at a different time as regards the agent and as regards parties.

Hence, third parties may deal with the agent, as such, till they come to know of the termination of the authority. For example, A directs B to sell goods for him, and agrees to give B five per cent commission on the price fetched by the goods. Afterwards by letter, revokes B's authority. After the letter was sent, but before B received it, B sold the goods for 100 rupees. The sale is binding on A. and B is entitled to the agreed commission.

Let us take another example, A, at Delhi by letter directs his agent B to sell for him some mustard oil lying in a warehouse in Kolkata. Later on A by a letter revokes B's authority to sell and directs B to despatch the mustard oil to Delhi. B after receiving the letter of revocation enters into a contract with C who knows of the first letter and has no knowledge of the second letter, whereby C agrees to buy the mustard oil from the agent. C paid the price to the agent who runs away with the money. A is bound by the contract and C's payment is good as against A.

11.16 IRREVOCABLE AGENCY

The term 'irrevocable agency' means an agency which cannot be revoked or terminated by the principal. Contract Act envisages the following circumstances when the agency is irrevocable:

i) **If the agency is coupled with interest:** You have already learnt in this unit that when the agency is created for securing some benefit to the agent in addition to his remunerations as agent, such agency is termed as 'agency

coupled with interest'. In this regard let us read Section 202 which defines such agency. It says *where the agent has himself an interest in the property which forms the subject matter of the agency, cannot in the absence of an express contract, be terminated to the prejudice of such interest*. In other words, where an agent has some interest in the subject matter of the agency, it cannot be terminated so long as the interest subsists. For example, A owes Rs. 10,000 to B and A authorises B to sell A's house in Agra and to pay himself out of the proceeds. Once A has authorised B, A cannot terminate the agency nor will this agency be terminated by the death of A or on A's becoming of unsound mind. Here we should note that in order to avail the benefit of this principle, it must he remembered that the object of creating the agency is to secure some benefit to the agent. The rule is not applicable to those agencies in which the interest arises after the creation of agency. To distinguish this situation let us study this example, A entrusts 100 bales of cotton to B and directs B to sell them on A's behalf. Later on, B advances some money to A. A fails to repay the money and also directs B not to sell the bales of cotton. Ignoring A's directions and to recover his money, sells the cotton bales. B cannot sell, because when the agency was created it was not coupled with interest, the agent's interest arose after the creation of agency.

ii) **Where the agent has partly exercised his authority:** Section 204 presents another situation where agency is irrevocable. It says *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 as arise from acts already done in the agency*. It means that the principal cannot revoke the agent's authority for this acts already done, and the principal shall he liable for such acts which have already been done on his behalf. For example, A authorises his agent B to buy 1,000 tons of stainless steel sheets on A's account and to make the payment out of A's money remaining in B's hands. The agent buys the sheets in the name of his principal. A cannot revoke agent's authority so far as regards payment for 1,000 tons of stainless steel sheets is concerned.

iii) **When the agent has incurred a personal liability:** If in pursuance of a contract of agency, the agent has entered into any contract and has incurred some personal liability, the principal cannot revoke the agency. Because if the principal is thus allowed to revoke the authority of the agent, it would expose the agent to the risk and liability already incurred by him. For example, if in the above-mentioned example, the agent buys the stainless steel sheets in his own name instead in the name of his principal, the agent makes him personally liable. Hence, the agency becomes irrevocable and the principal cannot unilaterally terminate the agency.

Check Your Progress C

1. Mention any two circumstances in which an agent incurs personal liability.

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2. Who is an undisclosed principal?

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3. When does termination of an agency take effect?

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4. How would you decide the following cases?

   i) A, being B's agency with authority to receive money on his behalf, receives from C a sum of money due to B. Is C discharged of his obligation?

   ii) R authorises E to buy 300 sheeps for him. E buys 300 sheeps and 100 lambs for a lump sum of Rs. 5,000. What remedy is open to R?

   iii) A who owes Rs. 500 to B, sells Rs. 1,000 worth of rice to B. A is acting as agent for C in the transaction but B has no knowledge nor reasonable ground of suspicion that such is the case. What is the position of C against B in taking rice?

   iv) 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. What is the right of A in this case?

   v) A consigns goods to B for sale, and gives him instructions not to sell under a fixed price. C, being ignorant of A's instructions, enters into a contract with B to buy the goods at a price lower than the reserved price, Is A, the principal bound by the contract?

11.17 LET US SUM UP

An agent is a person who represents another person, called principal, in dealings with third parties. A minor or a person of unsound mind can be an agent but not a principal, The principal must be a major and of sound mind, No consideration is necessary to create an agency.

An agent is different from a servant and an independent contractor. He occupies an intermediate place between the two. A wife is not an agent of a husband. She must receive authority from her husband either expressly or by implication from his conduct. She call pledge the credit of her husband only under certain conditions.

An agency can be created by (a) express agreement, (b) implied agreement, (c) ratification, (d) operation of law. Agency by implied agreement may be by (i) holding out, (ii) estoppel and (iii) necessity. Authority of an agent may be express or implied and ostensible.

An agent cannot delegate his authority and appoint a sub-agent. But there are some exceptions to this rule. A sub-agent is different from a substituted agent.

If an agent exceeds his authority or does any act without authority, the principal may ratify or disown them. Ratification means affirmation and it relates back to the date on which the ratified act was originally done by the agent. For a valid ratification certain conditions must be satisfied.

The rights of an agent are: (1) right to receive remuneration, (2) right of retainer, (3) right of lien, (4) right to be indemnified. The duties of an agent are: (1) to act according to the instructions or custom of the trade, (2) to act with reasonable care and skill. (39 to render accounts, (4) to communicate with principal, (5) not to deal on his own account, (6) not to use information obtained in the course of the agency against the principal, (7) not to set-up adverse title, (8) not to make personal secret profits, (9) to exercise his authority himself (10) to take all reasonable steps to protect the interest of the principal on his death or insanity.

An agent is personally liable: (1) when he expressly agrees, (2) when acting for a foreign principal, (3) when acting for an undisclosed principal, (4) where the principal, though discovered, cannot be sued, (5) where the principal is a company which is yet to come into existence, (6) when the agent's authority is "coupled with interest", (7) if custom or trade usage is such, (8) where agent receives money by mistake or fraud (9) where agent exceeds or deals without authority, (10) when agent enters into contract in his own name.

The liability of a principal to third parties fall under three heads: (a) Where both existence and name of the principal is disclosed (named principal), the principal is liable for acts of the agents that are within agent's authority. He is also liable for misrepresentation or fraud done by the agent, notice given to or information obtained or admissions made by the agent in the course of business. (b) If only existence and not the name of the principal is disclosed, the principal is, provided he is in existence at the time of the contract, liable for the contracts made by the agent. (c) Where neither the principal's existence nor his name is disclosed (undisclosed principal), the agent can sue or be sued by the third party as he is personally liable.

An agency may be terminated by (a) act of the parties i.e., by the principal or by the agent or by agreement of both, or (b) operation of law. This occurs on completion of business, on death or unsoundness of mind of any party, on insolvency of the principal, on destruction of the subject matter, on expiry of the fixed period of agency, on dissolution of company (either as principal or agent), or on principal becoming an alien enemy. The agency is terminated when agent comes to know of it and for third parties when they come to know of it.

An agency is irrevocable: (i) if the agency is 'coupled with interest', (ii) when authority has been partly exercised by the agent, and (iii) when the agent has incurred personal liability.

11.18 KEY WORDS

Agent and Principal : An agent is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is so represented, is called the principal.

Agency by Estoppel : When a person by his words or conduct has wilfully led another to believe that certain set of circumstances or facts exist, and that other person had acted on that belief, he is estopped or precluded from denying the truth of such statements.

Agency by Holding Out : There is some affirmative conduct on the part of the principal.

Agency by Necessity : Sometimes, exigencies of circumstances require that a person who is not really an agent, should act as an agent of another.

Agency by Ratification : If the agent had no authority to contract on behalf of principal or exceeds such authority, the principal, can subsequently validate the act by signifying his approval.

Auctioneer Auctioneer is an agent who is entrusted with possession of goods for sale to the highest bidder in public competition.

Actual Authority : It is created by agreements to which the principal and agents alone are parties.

Agency Coupled with Interest: Where an agent has an interest in the subject matter of the contract which he signs.

Broker : A broker is one who makes bargains for another and receives commission (brokerage) for so doing.

Del Credere Agent : A Del Credere Agent is an agent, who in consideration of an extra remuneration called the Del Credere commission, guarantees to his principal that the third persons with whom he enters into contracts shall perform their obligations.

Delegatus non potest delegare : A delegate cannot further delegate, (i.e. ,) one cannot delegate that which one has himself undertaken to do.

Factor : A person who is entrusted with the possession of goods, and who has the authority to buy, or sell or otherwise deal with goods or to raise money on their security.

Ostensible Authority of an Agent : When a person is held out as an agent for a particular purpose or business, persons dealing with him are entitled to presume that he has the authority to do all such acts as are necessary or incidental to such a business.

Special Agent : One who has authority to act in a particular transaction.

Sub-agent : A person who is employed by and acting under the control of the original agent.

Substituted Agent : An agent who is named by the original agent and he acts directly under the control of principal.

11.19 ANSWERS TO CHECK YOUR PROGRESS

A) 6. i) False ii) True iii) True iv) False v) False
vi) False vii) True viii) False

7. i) This comes under agency by estoppel. In this case 'A' the principal is liable to C.

ii) Yes, the principal is liable to pay C on the principle of Agency by holding out. A , having hold out B as his agent on a previous occasion, becomes bound by subsequent transactions entered into under similar circumstances.

iii) No, A was not responsible. Delegation of authority by one advocate to another is a common usage in that profession, unless otherwise agreed upon by the client and the advocate 'A'. B is the substituted agent.

iv) A substituted agent is liable directly to the principal. Hence, lawyer is not responsible to Z.

B) 5. i) False ii) True iii) True iv) True v) True

vi) True vii) False viii) False ix) True.

C) 4. i) Yes, C is discharged of his obligation to pay the sum in question to B (Section 226),

ii) R may repudiate the whole transaction (Section 228).

iii) C cannot compel B to take the rice without allowing him to set off A's debt (Section 232).

iv) A may sue either B or C or both (Section 233).

v) A is bound by the Contract (Section 237).

11.20 TERMINAL QUESTIONS

1) Define 'agent' and 'principal'. Can a minor be an agent? Discuss.

2) How can an agency be created?

3) To what extent a wife can pledge her husband's credit when (i) she is living with him and (ii) she is living separately?

4) Examine the rights and duties of an agent.

5) When may an agent sue or be sued personally on contracts entered into by him on behalf of his principal?

6) 'Delegatus non potest delegare'. Discuss the implications of this maxim in relation to agency and state the exceptions to the rule.

7) Explain the scope of principal's liability for the acts of his agent when the agent has acted: (i) with ostensible authority; (ii) in the course of his business.

8) 'A principal has the power to revoke the authority of the agent; but he does not have the right to do so'. Explain and illustrate the truth of this statement.

9) In what circumstances may a person ratify a contract made on his behalf but without his authority?

10) If an agent acts for (a) a disclosed principal, (b) an undisclosed principal, and (c) unnamed principal, state the respective rights of the agent, the principal, and the third parties.

11) Examine the various ways by which a contract of agency may be terminated.

12) When is an agency irrevocable?

Note : These questions will help you to understand the unit better. Try to write answers for them. But, do not submit your answers to the University for assessment. These are for your own practice only.

SOME USEFUL BOOKS

M. C. Kuchhal, and Vivek Kuchhal, Business Law, Vikas Publishing House, New Delhi.

Avtar Singh, Business Law, Eastern Book Company, Lucknow.

S. N. Maheshwari and SK Maheshwari, Business Law, National Publishing House, New Delhi.

G. K. Kapoor Business Laws, Scholar Tech Press, New Delhi.

P. C. Tulsian and Bharat Tulsian, Business Law, McGraw Hill Education.

Sharma, J. P. and Sunaina Kanojia, Business Laws, Ane Books Pvt. Ltd., New Delhi.

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